

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



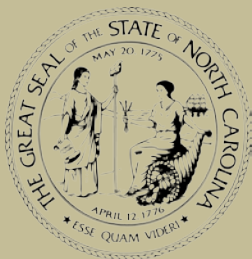
USS NORTH CAROLINA BATTLESHIP COMMISSION

WILMINGTON, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

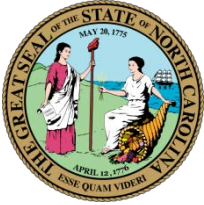
FOR THE YEAR ENDED SEPTEMBER 30, 2016

A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA



NC  **OSA**
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, Governor
The General Assembly of North Carolina
Board of Commissioners, USS North Carolina Battleship Commission

We have completed a financial statement audit of the USS North Carolina Battleship Commission for the year ended September 30, 2016, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads 'Beth A. Wood'.

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
USS North Carolina Battleship Commission
Wilmington, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the USS North Carolina Battleship Commission (Commission), a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Friends of the Battleship North Carolina, Inc., the Commission's discretely presented component unit. Those statements were audited by other auditors, whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for the Friends of the Battleship North Carolina, Inc., are based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the Friends of the Battleship North Carolina, Inc. were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Commission's preparation and fair presentation of

the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the USS North Carolina Battleship Commission, and its discretely presented component unit, as of September 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and other required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated August 14, 2017 on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commission's internal control over financial reporting and compliance.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

August 14, 2017



MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the financial report presents Management's Discussion and Analysis and provides an overview of the financial activities of the USS North Carolina Battleship Commission (Commission) for the fiscal year ended September 30, 2016, with comparative data for the fiscal year ended September 30, 2015. Since management's discussion and analysis is designed to focus on current activities, resulting change and currently known facts, please read it in conjunction with the Commission's basic financial statements and notes to the financial statements. The basic financial statements include a Statement of Net Position, Statement of Revenues, Expenses, and Changes in Net Position, Statement of Cash Flows, and Notes to the Financial Statements. Responsibility for the completeness and fairness of this information rests with the Commission.

While the financial statements reflect on the Commission as a whole, the Commission is an enterprise, non-appropriated fund activity of the State of North Carolina that is required by general statute to be self-sufficient for its annual operations. Funding for the annual operation of the Commission is met primarily from revenues generated through admissions to tour the ship and gift shop sales, hence a principal focus on the Statement of Revenues, Expenses, and Changes in Net Position. See Note 1A for more information.

Financial Highlights

Visitation to the Battleship North Carolina Memorial (Battleship) for fiscal year 2016 included 208,936 paid visitors; 3,477 visitors from special events, rentals and programs; and 6,066 five-and-under visitors. Fiscal year 2015 visitation included 212,369 paid visitors; 3,522 visitors from special events, rentals and programs; and 11,034 five-and-under visitors. The decrease in total visitation of 3.73% was due to weather conditions, including higher than normal temperatures, higher rainfall totals, and recurring flooding events, which limited access to the Battleship Park grounds.

During fiscal year 2016, the Friends of the Battleship North Carolina, Inc. (Friends) continued the Generations Campaign (Campaign). The Campaign is a capital campaign effort to continue the mission of the Battleship as a living memorial to those who served their country.

The Friends received grants and contributed funding to support upgrades for the Battleship fire alarm system, purchases of retardant cabinets for storage of flammable items and non-slip paint for the on and off ramps to the Battleship.

The Campaign contributed funds to the Battleship for expenses associated with outreach, construction of the State Employees' Credit Union Memorial Walkway and cofferdam, displays for education, and televisions and audio visual equipment for enhancement of the visitor's experience on the tour route.

Campaign gifts are received by the discretely presented component unit, the Friends. The Friends is a nonprofit 501(c)(3) charitable organization with the purpose of promoting and supporting the Battleship.

The following table summarizes the major categories of assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position and their corresponding changes.

Condensed Statement of Net Position
For the Years Ended September 30, 2016 and 2015
(in thousands)

	2016	2015	Increase (Decrease)	Percent Change
Current Assets	\$ 10,661.86	\$ 8,074.13	\$ 2,587.73	32.05%
Noncurrent Assets:				
Restricted Cash and Cash Equivalents	1,944.43		1,944.43	
Capital Assets, Nondepreciable	466.88	258.74	208.14	80.44%
Capital Assets, Depreciable, Net	2,160.75	2,229.30	(68.55)	-3.07%
Total Assets	<u>15,233.92</u>	<u>10,562.17</u>	<u>4,671.75</u>	44.23%
Deferred Outflows Related to Pensions	<u>476.72</u>	<u>31.50</u>	<u>445.22</u>	1413.40%
Current Liabilities	3,029.39	192.76	2,836.63	1471.59%
Noncurrent Liabilities	<u>790.73</u>	<u>416.19</u>	<u>374.54</u>	89.99%
Total Liabilities	<u>3,820.12</u>	<u>608.95</u>	<u>3,211.17</u>	527.33%
Deferred Inflows Related to Pensions	<u>202.33</u>	<u>51.13</u>	<u>151.20</u>	295.72%
Net Position:				
Net Investment in Capital Assets	2,419.22	2,488.04	(68.82)	-2.77%
Restricted	1,994.51	308.59	1,685.92	546.33%
Unrestricted	<u>7,274.46</u>	<u>7,136.96</u>	<u>137.50</u>	1.93%
Total Net Position	<u>\$ 11,688.19</u>	<u>\$ 9,933.59</u>	<u>\$ 1,754.60</u>	17.66%

The increase in current assets of 32.05% was due to increased funds received from the Friends for renovations to the Battleship.

Current assets increased \$2.6 million and noncurrent restricted cash and cash equivalents increased \$1.9 million primarily due to the receipt of funds from the Friends for the long-term State Employees' Credit Union Memorial Walkway and cofferdam projects. The nondepreciable capital assets increase of 80.44% was related to the completion of the Wi-Fi installation and the addition of \$229,756 of costs associated with the construction of the State Employees' Credit Union Memorial Walkway.

The increase of 1,471.59% in current liabilities is attributable to \$2.6 million of funding received from the Campaign for construction of the State Employees' Credit Union Memorial Walkway to be performed in subsequent fiscal years and recorded as unearned revenue in the Statement of Net Position as of September 30, 2016.

Noncurrent liabilities increased 89.99% due primarily to the increase in the net pension liability of \$376,997 which was due to the increase in the collective net pension liability for the Teachers' and State Employees' Retirement System (TSERS). This increased as a result of increases in current year service costs, interest on the net pension liability, changes of assumptions, and lower investment earnings. These factors also account for the more than \$445 thousand and \$151 thousand increases in deferred outflows and inflows of resources in fiscal year 2016 (See Note 11 for detailed information).

Restricted net position increased 546.33% as a result of the funds received from the Friends for the State Employees' Credit Union Memorial Walkway and cofferdam projects.

Capital Assets

As of September 30, 2016, the Battleship recorded \$5.1 million in gross capital assets, \$2.5 million in accumulated depreciation, and \$2.6 million in net capital assets. The following table depicts the changes in the two years presented:

	2016	2015 (As Restated)	Increase (Decrease)	Percent Change
Capital Assets				
Land	\$ 97.43	\$ 97.43	\$ 0.00	0.00%
Construction in Progress	369.45	161.31	208.14	129.03%
Buildings	1,172.60	1,172.60	0.00	0.00%
Machinery and Equipment	362.63	403.15	(40.52)	-10.05%
Infrastructure	3,134.16	3,082.15	52.01	1.69%
Total	5,136.27	4,916.64	219.63	4.47%
Less: Accumulated Depreciation	2,508.64	2,428.60	80.04	3.30%
Capital Assets, Net	\$ 2,627.63	\$ 2,488.04	\$ 139.59	5.61%

The 129.03% increase in construction in progress was due to construction costs associated with the State Employees Credit Union Memorial Walkway totaling \$229,755.99 and the completion of the \$52,017.99 Wi-Fi project. See Note 7 for further details.

Statement of Revenues, Expenses, and Changes in Net Position

The Statement of Revenues, Expenses, and Changes in Net Position reflect an overall increase in net position for the fiscal year ending September 30, 2016. The following table identifies variances between the two fiscal years.

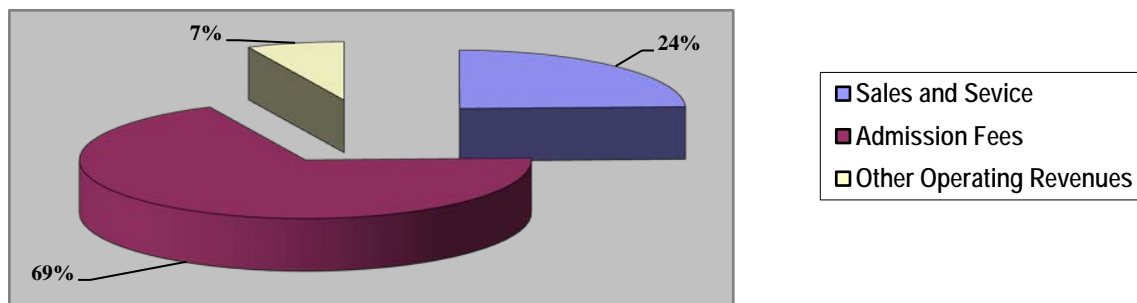
	2016	2015	Increase (Decrease)	Percent Change
Operating Revenues:				
Sales and Services	\$ 841.49	\$ 783.84	\$ 57.65	7.35%
Admission Fees	2,354.97	2,376.02	(21.05)	-0.89%
Other Operating Revenues	239.41	258.06	(18.65)	-7.23%
Total Operating Revenue	3,435.87	3,417.92	17.95	0.53%
Less Operating Expenditures	3,680.87	3,224.32	456.55	14.16%
Operating Income (Loss)	(245.00)	193.60	(438.60)	-226.55%
Other Revenues and Losses				
Investment Income (Loss), Net	96.40	(68.12)	164.52	241.51%
Other Nonoperating Expenses		(14.10)	14.10	
Capital Gifts	1,548.86	124.51	1,424.35	1143.96%
Noncapital Gifts	354.34	334.98	19.36	5.78%
Capital Asset Impairment Loss		(317.68)	317.68	
Increase in Net Position	1,754.60	253.19	\$ 1,501.41	-593.00%
Net Position, Beginning of Year	9,933.59	9,984.10		
Restatement		(303.70)		
Net Position, End of Year	\$ 11,688.19	\$ 9,933.59		

Fiscal year 2015-2016 total revenues are \$5,435.47 and total expenses are \$3,680.87.
Fiscal year 2014-2015 total revenues are \$3,877.41 and total expenses are \$3,624.22.

During fiscal year 2016, the Commission opted to liquidate the investment portfolio and transfer the balance to the State Treasurer's Short-Term Investment Fund (STIF) account. The interest rate in the STIF was higher and less volatile than the investment portfolio and resulted in an increase in investment income of 241.51%.

An increase of 1,143.96% in capital gifts was a result of the Campaign contributing more than \$1.5 million of funds for the design, engineering and construction of the State Employees' Credit Union Memorial Walkway.

Operating revenues are primarily related to admission fees received from visitation and sales and services. The following is a graphic illustration of operating revenues by source as described above.

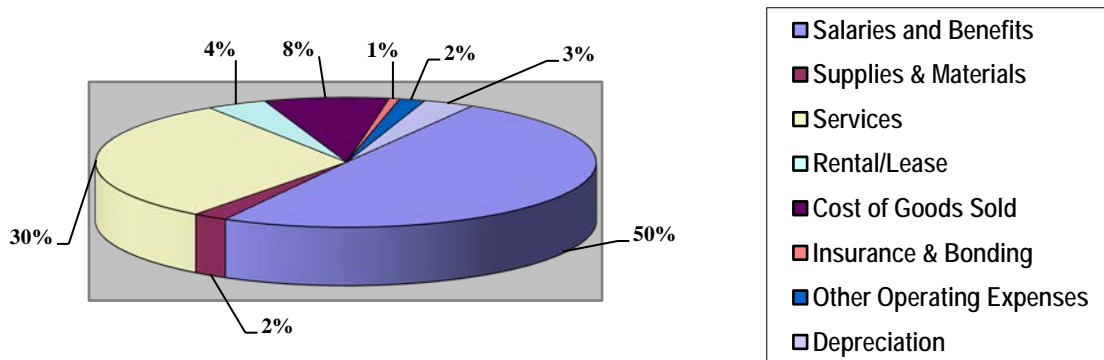


The following table identifies variances between the two fiscal years for the components of operating expenses.

Operating Expense	2016	2015	Increase (Decrease)	Percent Change
Salaries and Benefits	\$ 1,828.27	\$ 1,575.71	\$ 252.56	16.03%
Supplies and Materials	81.93	79.36	2.57	3.24%
Services	1,125.63	898.93	226.70	25.22%
Rental/Lease	143.09	142.40	0.69	0.48%
Cost of Goods Sold	295.18	312.10	(16.92)	-5.42%
Depreciation	120.57	124.09	(3.52)	-2.84%
Insurance and Bonding	24.98	24.35	0.63	2.59%
Other Operating Expenses	61.22	67.38	(6.16)	-9.14%
Total	\$ 3,680.87	\$ 3,224.32	\$ 456.55	14.16%

The increase of 14.16% in operating expenditures was due to an increase in salaries and benefits for bonuses, merit pay, and the addition of a new staff position. The remaining increase was due to construction costs associated with the completion of repairs to the wardroom.

The following is a graphic illustration of operating expenses by source as described above.



Financial Outlook

As it has for virtually all businesses, the state of the economy requires a more conservative approach to revenue projections and a more stringent control of discretionary expenditures. With tourists continuing to choose shorter duration vacations closer to home, the Commission’s marketing focus has continued to focus on advertising in-state and in neighboring states.

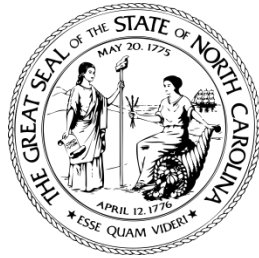
In the longer term, the Battleship is expected to continue its financial success as a state enterprise due to its proven reputation as one of the most historically accurate ships of the WWII age and an increase in hotel construction in the Wilmington area.

As in past years, the Battleship visitation is extremely dependent on weather, temperature extremes, flooding, and hurricanes. The Battleship visitation has been impacted by an El Nino weather pattern of higher than normal temperatures and rain for the past 2 years. More seasonal temperatures and moderate weather is expected as the El Nino weather pattern transitions to a more “normal” state.

Additionally, construction of the Battleship cofferdam and the State Employees’ Credit Union Memorial Walkway, which will create a new opportunity to view the ship from an elevated timber frame walkway, has created a higher level of interest in the Battleship within the travel and tourism world. Project construction is scheduled to be completed in November 2017. The next phase of the project will include the removal and replacement of the steel on the hull of the Battleship.

There are also plans for the construction of the Battleship North Carolina Marine Trail (Marine Trail). The Marine Trail is a collective term that includes construction of a new “host” dock servicing commuter transportation to and from Wilmington hotels, and a kayak launch for marine access to the Cape Fear River to access historical and natural interest items in the operating area.

The Marine Trail is a multipurpose project and is financially supported by donations from Piedmont Natural Gas and funds raised from the Generations Campaign.



FINANCIAL STATEMENTS

USS North Carolina Battleship Commission
Statement of Net Position
September 30, 2016

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 7,259,586.41
Restricted Cash and Cash Equivalents	2,637,927.07
Receivables (Note 4)	366,403.49
Inventories	235,798.49
Prepaid Items	162,150.71
	<hr/>
Total Current Assets	10,661,866.17

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,944,426.05
Capital Assets - Nondepreciable (Note 7)	466,878.79
Capital Assets - Depreciable, Net (Note 7)	2,160,746.46
	<hr/>
Total Noncurrent Assets	4,572,051.30

Total Assets	<hr/> 15,233,917.47 <hr/>
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DEFERRED OUTFLOWS OF RESOURCES

Deferred Outflows Related to Pensions	<hr/> 476,722.00 <hr/>
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 8)	375,540.48
Unearned Revenue	2,637,927.07
Long-Term Liabilities - Current Portion (Note 9)	15,917.91
	<hr/>
Total Current Liabilities	3,029,385.46

Noncurrent Liabilities:

Long-Term Liabilities (Note 9)	<hr/> 790,730.21 <hr/>
Total Liabilities	<hr/> 3,820,115.67 <hr/>

DEFERRED INFLOWS OF RESOURCES

Deferred Inflows Related to Pensions	<hr/> 202,326.00 <hr/>
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NET POSITION

Net Investment in Capital Assets	2,419,229.72
Restricted for:	
Expendable:	
Restoration Projects	1,994,508.38
Unrestricted	<hr/> 7,274,459.70 <hr/>
Total Net Position	<hr/> \$ 11,688,197.80 <hr/>

The accompanying notes to the financial statements are an integral part of this statement.

USS North Carolina Battleship Commission
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended September 30, 2016

Exhibit A-2

REVENUES

Operating Revenues:	
Sales and Services	\$ 841,493.73
Admission Fees	2,354,966.00
Rentals	74,075.00
Commissions	126,406.07
Special Events	33,166.35
Miscellaneous	5,766.78
	<hr/>
Total Operating Revenues	3,435,873.93
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	1,828,271.86
Supplies and Materials	81,917.80
Services	1,125,631.72
Rental/Lease	143,087.84
Cost of Goods Sold	295,176.25
Depreciation	120,570.79
Insurance and Bonding	24,987.04
Other Operating Expenses	61,224.26
	<hr/>
Total Operating Expenses	3,680,867.56
	<hr/>
Operating Loss	(244,993.63)
	<hr/>

NONOPERATING REVENUES

Noncapital Gifts	354,336.65
Investment Income (Net of Investment Expense of \$1,798.65)	96,402.65
	<hr/>
Total Nonoperating Revenues	450,739.30
	<hr/>
Income Before Other Revenues	205,745.67
	<hr/>
Capital Gifts	1,548,858.31
	<hr/>
Increase in Net Position	1,754,603.98

NET POSITION

Net Position - October 1, 2015	9,933,593.82
	<hr/>
Net Position - September 30, 2016	\$ 11,688,197.80
	<hr/> <hr/>

The accompanying notes to the financial statements are an integral part of this statement.

USS North Carolina Battleship Commission
Statement of Cash Flows
For the Fiscal Year Ended September 30, 2016

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 3,432,403.89
Payments to Employees and Fringe Benefits	(1,715,539.39)
Payments to Vendors and Suppliers	<u>(1,758,725.92)</u>
Net Cash Used by Operating Activities	<u>(41,861.42)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Noncapital Gifts	<u>359,420.86</u>
Cash Provided by Noncapital Financing Activities	<u>359,420.86</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Gifts	4,136,703.05
Acquisition and Construction of Capital Assets	<u>(73,378.45)</u>
Net Cash Provided by Capital Financing and Related Financing Activities	<u>4,063,324.60</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	1,613,709.28
Investment Income	62,117.12
Purchase of Investments and Related Fees	<u>(90,917.75)</u>
Net Cash Provided by Investing Activities	<u>1,584,908.65</u>
Net Increase in Cash and Cash Equivalents	5,965,792.69
Cash and Cash Equivalents - October 1, 2015	<u>5,876,146.84</u>
Cash and Cash Equivalents - September 30, 2016	<u>\$ 11,841,939.53</u>

USS North Carolina Battleship Commission
Statement of Cash Flows
For the Fiscal Year Ended September 30, 2016

Exhibit A-3
Page 2 of 2

**RECONCILIATION OF NET OPERATING LOSS
TO NET CASH USED BY OPERATING ACTIVITIES**

Operating Loss	\$ (244,993.63)
Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities:	
Depreciation	120,570.79
Pension Expense	108,297.00
Changes in Assets and Deferred Outflows of Resources:	
Receivables	(10,638.77)
Inventories	(2,691.74)
Prepaid Items	(21,784.79)
Deferred Outflows for Contributions Subsequent to the Measurement Date	(28,544.00)
Changes in Liabilities:	
Accounts Payable and Accrued Liabilities	29,469.81
Unearned Revenue	7,168.73
Compensated Absences	1,285.18
	<hr/>
Net Cash Used by Operating Activities	<u><u>\$ (41,861.42)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 7,259,586.41
Restricted Cash and Cash Equivalents	2,637,927.07
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<hr/> 1,944,426.05
Total Cash and Cash Equivalents - September 30, 2016	<u><u>\$ 11,841,939.53</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	\$ 60,923.87
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The accompanying notes to the financial statements are an integral part of this statement.

Friends of the Battleship North Carolina, Inc.
Statement of Financial Position
September 30, 2016

Exhibit B-1

	Unrestricted	Temporarily Restricted	Total
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 153,690	\$ 691,565	\$ 845,255
Grants and Other Receivables	4,173		4,173
Pledges Receivable		1,737,267	1,737,267
Total Current Assets	<u>157,863</u>	<u>2,428,832</u>	<u>2,586,695</u>
Noncurrent Assets:			
Due to (from)	389,058	(389,058)	
Pledges Receivable - Noncurrent, Net		69,833	69,833
Total Noncurrent Assets	<u>389,058</u>	<u>(319,225)</u>	<u>69,833</u>
Total Assets	<u>\$ 546,921</u>	<u>\$ 2,109,607</u>	<u>\$ 2,656,528</u>
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 2,249	\$ 0	\$ 2,249
Battleship Payable	344,287		344,287
Unearned Revenue	3,050	219,083	222,133
Total Liabilities	<u>349,586</u>	<u>219,083</u>	<u>568,669</u>
NET ASSETS			
Unrestricted	197,335		197,335
Temporarily Restricted		1,890,524	1,890,524
Total Net Assets	<u>197,335</u>	<u>1,890,524</u>	<u>2,087,859</u>
Total Liabilities and Net Assets	<u>\$ 546,921</u>	<u>\$ 2,109,607</u>	<u>\$ 2,656,528</u>

The accompanying notes to the financial statements are an integral part of this statement.

Friends of the Battleship North Carolina, Inc.
Statement of Activities
For the Fiscal Year Ended September 30, 2016

Exhibit B-2

	Unrestricted	Temporarily Restricted	Total
SUPPORT AND REVENUE			
Contributions	\$ 6,372	\$ 275,277	\$ 281,649
Membership Dues	32,930		32,930
Grants		3,109,030	3,109,030
Net Assets Released from Restrictions	4,361,310	(4,361,310)	
Interest Income	528		528
Other Revenue	1,625		1,625
Total Support and Revenue	<u>4,402,765</u>	<u>(977,003)</u>	<u>3,425,762</u>
OPERATING EXPENSES			
Program	4,242,270		4,242,270
Administrative	8,403		8,403
Fundraising	105,186		105,186
Total Operating Expenses	<u>4,355,859</u>		<u>4,355,859</u>
Changes in Net Assets	46,906	(977,003)	(930,097)
NET ASSETS			
Net Assets at Beginning of Year	<u>150,429</u>	<u>2,867,527</u>	<u>3,017,956</u>
Net Assets at End of Year	<u>\$ 197,335</u>	<u>\$ 1,890,524</u>	<u>\$ 2,087,859</u>

The accompanying notes to the financial statements are an integral part of this statement.



NOTES TO THE FINANCIAL STATEMENT

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The USS North Carolina Battleship Commission (Commission) is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report* as an enterprise fund.

The accompanying financial statements present all funds belonging to the Commission and its component unit. While the Commission has ultimate responsibility, the Executive Director has been delegated responsibilities for financial accountability of the Commission's funds. The Commission's component unit is discretely presented in the Commission's financial statements. See below for further discussion of the Commission's component unit.

Financial statements for the Commission and its discretely presented component unit is presented as of and for the fiscal year ended September 30, 2016.

Discretely Presented Component Unit – The Friends of the Battleship North Carolina, Inc. (Friends) is a legally separate nonprofit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the Commission. The Friends was organized under the laws of North Carolina for the purposes of promoting and supporting the Battleship North Carolina. In fiscal year 2010, the Friends initiated a multi-year fundraising project called the Generations Campaign. Gifts to the Generations Campaign will help support construction of the State Employees Credit Union (SECU) Memorial Walkway, which is designed to provide greater public access to the Battleship, and the cofferdam, which will create a dry workspace for completing repairs to the Battleship's hull. These gifts will also be used to fund hull repairs and upgrades to educational programs enabling the work of memorizing the Battleship North Carolina and educating all those who come aboard to continue.

The Friends is a legally separate public nonprofit organization that reports its financial results under the Financial Accounting Standards Board (FASB) Codification. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Friends' financial information in the Commission's financial reporting entity for these differences.

During the year ended September 30, 2016, the Friends distributed \$4,159,601.00 to the Commission for both restricted and unrestricted purposes. Donations included contributions from various grantors for reimbursement of Commission expenses for safety, exhibit materials, restoration, volunteer training, landscaping on the grounds, design and permitting for an expedition trail, donor recognition displays, construction of the SECU Memorial Walkway, construction of the cofferdam, and reimbursement for direct expenses to the Generations Campaign. Complete financial statements for the Friends can be obtained by mailing a request to Friends of the Battleship North Carolina, Inc., P.O. Box 480, Wilmington, NC 28402, or by calling (910) 251-5797.

- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB.

Pursuant to the provisions of GASB Statement No. 34 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 35 - *Basic Financial Statements - and Management's Discussion and Analysis*, the full scope of the Commission's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

- C. Basis of Accounting** - The financial statements of the Commission have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

Nonexchange transactions, in which the Commission receives value without directly giving equal value in exchange include state appropriations, certain grants, donations, and investment income. Revenues are recognized as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty. The Commission's equity position in the STIF is recorded at fair value. Additional information regarding the fair value measurement of investments is disclosed in Note 3.

- E. Receivables** - Receivables consist of amounts due for commissions. Receivables also include amounts due from the Commission's discretely presented component unit in connection with reimbursement of allowable expenditures made pursuant to the Friends of the Battleship North Carolina, Inc. Generations Campaign Memorandum of Understanding.

Receivables are considered fully collectable and accordingly, no allowance for doubtful accounts is required.

- F. **Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at cost using the average cost method.
- G. **Capital Assets** - Capital assets are stated at cost at date of acquisition or acquisition value at date of donation in the case of gifts. Donated capital assets acquired prior to October 1, 2015 are stated at fair value as of the date of donation. The value of assets constructed includes all material direct and indirect construction costs.

The Commission capitalizes assets that have a value or cost of \$5,000 or greater at the date of acquisition and an estimated useful life of more than one year.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Buildings	38 years
Machinery & Equipment	6-50 years
General Infrastructure	30-75 years

The Commission does not capitalize the Battleship exhibit or its art and artifact collections. These collections adhere to the Commission’s policy to maintain for public exhibition, education, or research; protect, keep unencumbered, care for, and preserve; and require proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

- H. **Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted for the acquisition or construction of capital assets and resources whose use is limited by external parties.
- I. **Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include net pension liability and compensated absences that will not be paid within the next fiscal year.

The net pension liability represents the Commission’s proportionate share of the collective net pension liability reported in the State of North Carolina’s 2016 *Comprehensive Annual Financial Report*. This liability represents the Commission’s portion of the collective total pension liability less the fiduciary net position of the Teachers’ and State Employees’ Retirement System. See Note 11 for further information

regarding the Commission's policies for recognizing liabilities, expenses, and deferred outflows and inflows related to pensions.

- J. Compensated Absences** - The Commission's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at September 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and September 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

There is no liability for unpaid accumulated sick leave because the Commission has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

- K. Net Position** - The Commission's net position is classified as follows:

Net Investment in Capital Assets - This represents the Commission's total investment in capital assets, net of outstanding liabilities related to those capital assets. Additionally, deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of capital assets or related debt are also included in this component of net position.

Restricted Net Position - Expendable - Expendable restricted net position includes resources for which the Commission is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Position - Unrestricted net position includes resources derived from admission fees, sales and services, unrestricted gifts, royalties, and interest income.

When both restricted and unrestricted funds are available for expenditure, the decision for funding is internally generated by management of the Commission. Both restricted and unrestricted net position include consideration of deferred outflows and inflows of resources.

- L. Revenue and Expense Recognition** - The Commission classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Position. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Commission's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) admission fees, (2) sales and services, and (3) contracts for services. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9 - *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions that represent subsidies or gifts to the Commission, as well as investment income, are considered nonoperating since these are either investing, capital, or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

NOTE 2 - DEPOSITS AND INVESTMENTS

Cash on hand at September 30, 2016 was \$37,210.56. The carrying amount of the Commission's deposits not with the State Treasurer was \$6,378,010.72 and the bank balance was \$6,402,380.29. Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of September 30, 2016, of the Commission's bank balance, \$5,902,380.29 was exposed to custodial credit risk as it was uninsured and uncollateralized.

At September 30, 2016, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$5,426,718.25 which represents the Commission's equity position in the State Treasurer's Short-Term Investment Fund (STIF). The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.5 years as of September 30, 2016. Assets and shares of the STIF are valued at fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's STIF) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NOTE 3 - FAIR VALUE MEASUREMENTS

To the extent available, the Commission's investments are recorded at fair value as of September 30, 2016. GASB Statement No. 72 - *Fair Value*

Measurement and Application, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

- Level 1 Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.
- Level 2 Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.
- Level 3 Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

Short-Term Investment Fund – At year-end, all of the Commission's investments valued at \$5,426,718.25 were held in the STIF which is a Level 2 investment. Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

NOTE 4 - RECEIVABLES

Receivables at September 30, 2016, were as follows:

	<u>Amount</u>
Receivables:	
Commission Revenue	\$ 22,116.36
Due from Friends of the Battleship North Carolina, Inc.	<u>344,287.13</u>
	<u>\$ 366,403.49</u>

NOTE 5 - RESERVE FUND

In accordance with *North Carolina General Statute* 143B-74.1 the Commission established, on January 6, 1984, a cash reserve fund for contingencies and emergencies beyond those occurring in the course of routine maintenance and operation. This reserve is equal to one-half of the authorized operating budget for that fiscal year.

Accordingly, 50% of the authorized normal operating budget for fiscal year 2016 of \$3,765,721.50 yields a reserve requirement of \$1,882,860.75. For reporting purposes, this reserve is included in unrestricted net position. At year-end, the value of the unrestricted portion of the Commission's investments held in the State Treasurer's Short-Term Investment Fund was \$2,076,972.69 which exceeded the reserve requirement; the \$194,111.94 excess is considered available for operations and restoration projects.

NOTE 6 - RESTORATION FUND

In 1998, the Commission undertook a capital campaign (Operation Ship Shape) to raise funds for various restoration projects for the Battleship North Carolina. Projects and initiatives identified for funding by this campaign included restoration of the teak deck, restoration/refurbishment of the forward berthing area which came to be known as Overnight Camping, restorations of main deck exhibit area and wardroom, restoration of authentic ship components, relocation of utility lines, support of the State's construction of the cofferdam and other ongoing maintenance projects.

With \$6,100,000 in funds raised (cash and materials), the first completed projects were \$3,500,000 for teak deck repairs which consisted of donated deck and contracted services, and \$2,738,395 for emergency repairs made to the starboard bow. Design for overnight camping and wardroom renovations were initiated through several design firms, however, the projects have been postponed due to increasing costs. Having spent all funds originally raised during Operation Ship Shape 1998, there is no restricted funding available to complete the original projects.

Although the campaign has ended for these projects, contributions continue to be made to the Restoration Fund. For the fiscal year ending September 30, 2016, the Commission received donations in the amount of \$173,653.68.

In addition, the Commission received contributions of \$750,000 from the Generations Campaign and transferred \$2,369,549.42 to the Restoration Fund in support of the cofferdam. At year end, these funds were on deposit with BB&T with an ending restricted and unrestricted balance of \$3,599,991.59.

NOTE 7 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended September 30, 2016, is presented as follows:

	Balance October 1, 2015 (As Restated)	Increases	Decreases	Balance September 30, 2016
Capital Assets, Nondepreciable:				
Land	\$ 97,425.80	\$ 0.00	\$ 0.00	\$ 97,425.80
Construction in Progress	<u>161,318.69</u>	<u>229,755.99</u>	<u>21,621.69</u>	<u>369,452.99</u>
Total Capital Assets, Nondepreciable	<u>258,744.49</u>	<u>229,755.99</u>	<u>21,621.69</u>	<u>466,878.79</u>
Capital Assets, Depreciable:				
Buildings	1,172,596.54			1,172,596.54
Machinery and Equipment	403,154.04		40,525.85	362,628.19
General Infrastructure	<u>3,082,148.63</u>	<u>52,017.99</u>		<u>3,134,166.62</u>
Total Capital Assets, Depreciable	<u>4,657,899.21</u>	<u>52,017.99</u>	<u>40,525.85</u>	<u>4,669,391.35</u>
Less Accumulated Depreciation for:				
Buildings	984,070.66	30,676.60		1,014,747.26
Machinery and Equipment	261,059.46	22,499.44	40,525.85	243,033.05
General Infrastructure	<u>1,183,469.83</u>	<u>67,394.75</u>		<u>1,250,864.58</u>
Total Accumulated Depreciation	<u>2,428,599.95</u>	<u>120,570.79</u>	<u>40,525.85</u>	<u>2,508,644.89</u>
Total Capital Assets, Depreciable, Net	<u>2,229,299.26</u>	<u>(68,552.80)</u>		<u>2,160,746.46</u>
Capital Assets, Net	<u>\$ 2,488,043.75</u>	<u>\$ 161,203.19</u>	<u>\$ 21,621.69</u>	<u>\$ 2,627,625.25</u>

The capital assets, depreciable and related accumulated depreciation balances as of October 1, 2015 have been restated to reflect the reclassification of \$372,879.26 and \$57,773.19 previously recorded as machinery and equipment to general infrastructure and buildings, respectively.

NOTE 8 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at September 30, 2016, were as follows:

	Amount
Current Accounts Payable and Accrued Liabilities	
Accounts Payable	\$ 81,104.46
Accrued Payroll	86,040.49
Construction Payable	<u>208,395.53</u>
Total Current Accounts Payable and Accrued Liabilities	<u>\$ 375,540.48</u>

NOTE 9 - LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities for the year ended September 30, 2016, is presented as follows:

	Balance October 1, 2015	Additions	Reductions	Balance September 30, 2016	Current Portion
Net Pension Liability	\$ 299,815.00	\$ 376,997.00	\$ 0.00	\$ 676,812.00	\$ 0.00
Compensated Absences	128,550.94	85,102.60	83,817.42	129,836.12	15,917.91
Total Long-Term Liabilities	\$ 428,365.94	\$ 462,099.60	\$ 83,817.42	\$ 806,648.12	\$ 15,917.91

Additional information regarding the net pension liability is included in Note 11.

NOTE 10 - OPERATING LEASE OBLIGATIONS

The Commission entered into operating leases for a postage machine, safe, Wi-Fi router, and merchant services terminals. Future minimum lease payments under noncancelable operating leases consist of the following at September 30, 2016:

Fiscal Year	Amount
2017	\$ 9,650.10
2018	7,862.10
2019	7,412.70
Total Minimum Lease Payments	\$ 24,924.90

Rental expense for all operating leases during the year was \$143,087.84.

NOTE 11 - PENSION PLAN

Defined Benefit Plan

Plan Administration: The State of North Carolina administers the Teachers' and State Employees' Retirement System (TSERS) plan. This plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State to provide pension benefits for general employees and law enforcement officers (LEOs) of the State, general employees and LEOs of its component units, and employees of Local Education Agencies (LEAs) and charter schools not in the reporting entity. Membership is comprised of employees of the State (state agencies and institutions), universities, community colleges, and certain proprietary component units along with the LEAs and charter schools that elect to join the Retirement System. Benefit provisions are established by General Statute 135-5 and may be amended only by the North Carolina General Assembly.

Benefits Provided: TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

Contributions: Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their annual pay. The contribution rate for employers is set each year by the North Carolina General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The Commission's contractually-required contribution rate for the year ended September 30, 2016 was 9.15% of covered payroll. Employee contributions to the pension plan were \$68,437.28, and the Commission's contributions were \$104,366.85 for the year ended September 30, 2016.

The TSERS plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2016 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

TSERS Basis of Accounting: The financial statements of the TSERS plan were prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plan's fiduciary net position was determined on the same basis used by the pension plan.

Methods Used to Value TSERS Investment: Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The pension trust funds are the primary participants in the Long-term Investment portfolio and the sole participants in

the External Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Credit Investment, and Inflation Protection Investment portfolios. The Fixed Income Asset Class includes the Long-Term Investment and External Fixed Income Investment Portfolios. The Global Equity Asset Class includes the Equity Investment Portfolio. The investment balance of each pension trust fund represents its share of the fair market value of the net position of the various portfolios within the pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2016 *Comprehensive Annual Financial Report*.

Net Pension Liability: At September 30, 2016, the Commission reported a liability of \$676,812.00 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, and updated procedures were used to roll forward the total pension liability to June 30, 2016. The Commission’s proportion of the net pension liability was based on the present value of future salaries for the Commission relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2016, the Commission’s proportion was 0.00736%, which was a decrease of 0.00078 from its proportion measured as of June 30, 2015.

Actuarial Assumptions: The following table presents the actuarial assumptions used to determine the total pension liability for the TSERS plan at the actuarial valuation date:

Valuation Date	12/31/2015
Inflation	3%
Salary Increases*	3.5% - 8.10%
Investment Rate of Return**	7.25%

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer), and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2015 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

Future ad hoc Cost of Living Adjustment (COLA) amounts are not considered to be substantively automatic and are therefore not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical

performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Credit	6.0%
Inflation Protection	4.0%

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized.

Discount Rate: The discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate: The following presents the net pension liability of the plan calculated using the discount rate of 7.25%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25%) or 1-percentage point higher (8.25%) than the current rate:

Net Pension Liability		
1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
\$ 1,272,290.60	\$ 676,812.00	\$ 175,448.20

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended September 30, 2016, the Commission recognized pension expense of \$108,297.00. At September 30, 2016, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Employer Balances of Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions by Classification:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Actual and Expected Experience	\$ 0.00	\$ 29,126.00
Changes of Assumptions	90,885.00	
Net Difference Between Projected and Actual Earnings on Pension Plan Investments	219,782.00	
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	137,511.00	173,200.00
Contributions Subsequent to the Measurement Date	28,544.00	
Total	<u>\$ 476,722.00</u>	<u>\$ 202,326.00</u>

The amount of \$28,544.00 reported as deferred outflows of resources related to pensions will be included as a reduction of the net pension liability in the fiscal year ended September 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Schedule of the Net Amount of the Employer's Balances Deferred Outflows of Resources and Deferred Inflows of Resources That will be Recognized in Pension Expense:

Year ended June 30:	Amount
2018	\$ 37,071.00
2019	37,939.00
2020	109,009.00
2021	61,833.00
Total	<u>\$ 245,852.00</u>

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The Commission participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System (TSERS). Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135, Article 3B, of the General Statutes, and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of TSERS and contributions to the Fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are established by the General Assembly.

For the period October 1, 2015 through June 30, 2016, the Commission contributed 5.60% of the covered payroll under TSERS for these health care benefits, and for the period July 1, 2016 through September 30, 2016, the Commission contributed 5.81%. For the period July 1, 2015, through September 30, 2015, the Commission contributed 5.60%. For the period October 1, 2014 through June 30, 2015 the required contribution rate was 5.49%, for the period July 1, 2014 through September 30, 2014 the required contribution rate was 5.49%, for the period of October 1, 2013 through June 30, 2014 the required contribution rate was 5.40%. The Commission made 100% of its annual required contributions to the Plan for the years ended September 30, 2016, 2015, and 2014, which were \$63,874.79, \$56,216.12, and \$53,234.76, respectively. The Commission assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page

<http://www.osc.nc.gov/> and clicking on “Reports” or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

- B. Disability Income** - The Commission participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of TSERS. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the period October 1, 2015 through June 30, 2016, the Commission made a statutory contribution of .41% of covered payroll under TSERS to the DIPNC, and for the period July 1, 2016 through September 30, 2016, the Commission contributed .38%. For the fiscal year ended September 30, 2015, the Commission contributed 0.41%. The required contribution rate for the period July 1, 2014 through September 30, 2014 was 0.41% and for the period October 1, 2013 through June 30, 2014 was 0.44%. The Commission made 100% of its annual required contributions to the DIPNC for the years ended September 30, 2016, 2015, and 2014, which were \$4,573.01, \$4,174.47, and \$4,232.19, respectively. The Commission assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina’s *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

The Commission is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in state-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

A. Employee Benefit Plans

1. State Health Plan

Commission employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan has contracted with third parties to process claims.

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

B. Other Risk Management and Insurance Activities

1. Automobile, Fire, and Other Property Losses

The Commission is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the Commission for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

All state-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and \$10,000,000 per occurrence. The Commission pays premiums to the North Carolina Department of Insurance for the coverage.

2. Public Officers' and Employees' Liability Insurance

The risk of tort claims of up to \$1,000,000 per claimant is retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private insurance company. The Commission pays the premium, based on a composite rate, directly to the private insurer.

3. Employee Dishonesty and Computer Fraud

The Commission is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$100,000 deductible.

4. Statewide Workers' Compensation Program

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the Commission's primary responsibility is to arrange for

and provide the necessary treatment for work related injury. The Commission is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The Commission retains the risk for workers' compensation.

Additional details on the state-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

5. Other Insurance Held by the Commission

The Commission purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. The marine pollution control insurance which has a \$1,000,000 limit for costs and damages incurred from removal, response or remedial action during sudden, accidental, discharge, spillage, leakage, emission of hazardous substance into or upon navigable waters or adjoining shorelines.

NOTE 14 - COMMITMENTS

The Commission has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$6,675,330.56 and on other purchases were \$332,368.05 at September 30, 2016.

NOTE 15 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended September 30, 2016, the Commission implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 72 - Fair Value Measurement and Application

GASB Statement No. 76 - The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments

GASB Statement No. 72 provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB Statement No. 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

NOTE 16 - SUBSEQUENT EVENTS

On November 4, 2016, the Commission passed a motion to forgive a \$338,063 receivable from the Friends. The write-off is considered a contribution of fundraising efforts to restore the Battleship on behalf of the Commission.



REQUIRED SUPPLEMENTARY INFORMATION

**USS North Carolina Battleship Commission
 Required Supplementary Information
 Schedule of the Proportionate Net Pension Liability
 Teachers' and State Employees' Retirement System
 Last Three Fiscal Years**

Exhibit C-1

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Proportionate Share Percentage of Collective Net Pension Liability	0.00736%	0.00814%	0.00615%
Proportionate Share of TSERS Collective Net Pension Liability	\$ 676,812.00	\$ 299,815.00	\$ 72,129.00
Covered Payroll	\$ 1,140,621.26	\$ 1,018,162.26	\$ 981,120.99
Net Pension Liability as a Percentage of Covered Payroll	59.34%	29.45%	7.35%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	87.32%	94.64%	98.24%

**USS North Carolina Battleship Commission
 Required Supplementary Information
 Schedule of Commission Contributions
 Teachers' and State Employees' Retirement System
 Last Ten Fiscal Years**

Exhibit C-2

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Contractually Required Contribution	\$ 104,366.85	\$ 93,161.85	\$ 86,558.80	\$ 77,803.84	\$ 69,801.97
Contributions in Relation to the					
Contractually Determined Contribution	<u>104,366.85</u>	<u>93,161.85</u>	<u>86,558.80</u>	<u>77,803.84</u>	<u>69,801.97</u>
Contribution Deficiency (Excess)	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Covered Payroll	\$ 1,140,621.26	\$ 1,018,162.26	\$ 981,120.99	\$ 924,310.45	\$ 906,714.05
Contributions as a Percentage of Covered Payroll	9.15%	9.15%	8.82%	8.42%	7.70%

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Contractually Required Contribution	\$ 49,984.91	\$ 31,074.15	\$ 30,781.24	\$ 26,830.07	\$ 21,460.63
Contributions in Relation to the					
Contractually Determined Contribution	<u>49,984.91</u>	<u>31,074.15</u>	<u>30,781.24</u>	<u>26,830.07</u>	<u>21,460.63</u>
Contribution Deficiency (Excess)	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Covered Payroll	\$ 899,413.83	\$ 910,597.78	\$ 902,050.36	\$ 857,875.90	\$ 778,182.73
Contributions as a Percentage of Covered Payroll	5.56%	3.41%	3.41%	3.13%	2.76%

Note: Changes in benefit terms, methods, and assumptions are presented in the Notes to Required Supplementary Information (RSI) schedule following the pension RSI tables.

**USS North Carolina Battleship Commission
Notes to Required Supplementary Information
Schedule of Commission Contributions
Teachers' and State Employees' Retirement System
Last Ten Fiscal Years**

Changes of Benefit Terms:

Cost of Living Increase

2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
N/A	N/A	1.00%	N/A	N/A	N/A	2.20%	2.20%	3.00%	2.00%

Changes of assumptions. In 2008, 2012, and 2015, the actuarial assumptions were updated to more closely reflect actual experience. In 2015, the North Carolina Retirement Systems' consulting actuaries performed the quinquennial investigation of each retirement systems' actual demographic and economic experience (known as the "Experience Review"). The Experience Review provides the basis for selecting the actuarial assumptions and methods used to determine plan liabilities and funding requirements. The most recent Experience Review examined each plan's experience during the period between January 1, 2010, and December 31, 2014. Based on the findings, the Board of Trustees of the Teachers' and State Employees' Retirement System adopted a number of new actuarial assumptions and methods. The most notable changes to the assumptions include updates to the mortality tables and the mortality improvement projection scales to reflect reduced rates of mortality and significant increases in mortality improvements. These assumptions were adjusted to reflect the mortality projection scale MP-2015, released by the Society of Actuaries in 2015. In addition, the assumed rates of retirement, salary increases, and rates of termination from active employment were reduced to more closely reflect actual experience.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Commissioners
USS North Carolina Battleship Commission
Wilmington, North Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the USS North Carolina Battleship Commission (Commission), which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated August 14, 2017. Our report includes a reference to other auditors who audited the financial statements of the Friends of the Battleship North Carolina, Inc., as described in our report on the Commission's financial statements. The financial statements of the Friends of the Battleship North Carolina, Inc. were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the Friends of the Battleship North Carolina, Inc.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a

deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Commission's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Commission's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

August 14, 2017

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This audit required 315 hours at an approximate cost of \$32,445.