

Marine Corps Heritage Foundation
and Affiliate

Consolidated Audited Financial Statements
and Other Financial Information

*Years ended December 31, 2015 and 2014
with Report of Independent Auditors*

Marine Corps Heritage Foundation
and Affiliate

Consolidated Audited Financial Statements
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Years ended December 31, 2015 and 2014

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Report of Independent Auditors

Board of Directors
Marine Corps Heritage Foundation
Quantico, Virginia

We have audited the accompanying consolidated financial statements of Marine Corps Heritage Foundation and Affiliate (the Foundation) which comprise the consolidated statements of financial position as of December 31, 2015 and 2014, and the related consolidated statements of activities and cash flows for years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of December 31, 2015 and 2014 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note B, the consolidated financial statements have been restated to reflect the correction of a misstatement related to a change in depreciation policy of the Heritage Center. Our opinion has not been modified with respect to this matter.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Consolidating Statement of Financial Position, Consolidating Statement of Activities and Consolidated Statement of Functional Expenses (with summarized amounts for 2014), are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

A handwritten signature in black ink that reads "Johnson Lambert LLP". The signature is written in a cursive, flowing style with large loops and flourishes.

Falls Church, Virginia
April 15, 2016

Marine Corps Heritage Foundation
and Affiliate

Consolidated Statements of Financial Position

	December 31,	
	2015	2014
Assets		<i>(Restated)</i>
Cash and cash equivalents	\$ 14,229,655	\$ 10,972,673
Investments	19,601,761	20,275,152
Accounts receivable	151,808	1,010,769
Pledges receivable, net	19,156,682	21,869,506
Prepaid expenses	87,960	121,014
Inventory	-	326,513
Heritage Center, net	51,529,538	51,460,578
Fixed assets, net	184,292	328,139
Construction in progress	20,425,421	8,475,634
Cash surrender value of life insurance policy	121,354	122,498
Retirement plan assets	207,766	175,622
Deposits	9,189	9,189
Total assets	\$ 125,705,426	\$ 115,147,287
Liabilities and net assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 2,971,275	\$ 954,610
Notes payable	-	519,796
Retirement plan liability	207,766	175,622
Annuity payable	5,734	6,874
Agency funds	167,313	159,538
Total liabilities	3,352,088	1,816,440
Net assets:		
Unrestricted net assets	38,373,899	27,315,824
Temporarily restricted net assets	83,447,508	85,483,092
Permanently restricted net assets	531,931	531,931
Total net assets	122,353,338	113,330,847
Total liabilities and net assets	\$ 125,705,426	\$ 115,147,287

See accompanying notes to the financial statements.

Marine Corps Heritage Foundation
and Affiliate

Consolidated Statements of Activities

Year ended December 31, 2015
(with summarized amounts for 2014)

	2015			2014 Total <i>(Restated)</i>	
	Unrestricted	Temporarily Restricted	Permanently Restricted		Total
Revenue, gains and other support					
Contributions	\$ 14,766,763	\$ 2,775,202	\$ -	\$ 17,541,965	\$ 13,895,785
Retail rental income	320,230	-	-	320,230	-
Museum sales (net of cost of sales of \$78,400 in 2015 and \$1,122,041 in 2014)	10,988	-	-	10,988	1,246,707
Special events	208,760	-	-	208,760	231,795
In-kind support	39,041	114,089	-	153,130	536,364
Other revenue	266,561	-	-	266,561	264,356
Interest and dividends	229,418	18,421	-	247,839	256,356
Net assets released from restrictions	4,977,223	(4,977,223)	-	-	-
Total revenue, gains and other support	<u>20,818,984</u>	<u>(2,069,511)</u>	<u>-</u>	<u>18,749,473</u>	<u>16,431,363</u>
Expenses					
Program services	3,366,561	-	-	3,366,561	4,399,451
Program services - Heritage Center depreciation	3,166,981	-	-	3,166,981	3,156,876
Total program services	6,533,542	-	-	6,533,542	7,556,327
Fundraising	2,184,922	-	-	2,184,922	4,814,389
General and administrative	1,071,370	-	-	1,071,370	976,453
Total expenses	<u>9,789,834</u>	<u>-</u>	<u>-</u>	<u>9,789,834</u>	<u>13,347,169</u>
Change in net assets, before change in fair value of investments	11,029,150	(2,069,511)	-	8,959,639	3,084,194
Change in fair value of investments	28,925	33,927	-	62,852	(5,140)
Change in net assets	11,058,075	(2,035,584)	-	9,022,491	3,079,054
Net assets, beginning of year	27,315,824	85,483,092	531,931	113,330,847	110,251,793
Net assets, end of year	<u>\$ 38,373,899</u>	<u>\$ 83,447,508</u>	<u>\$ 531,931</u>	<u>\$ 122,353,338</u>	<u>\$ 113,330,847</u>

See accompanying notes to the financial statements.

Marine Corps Heritage Foundation
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Consolidated Statement of Activities

Year ended December 31, 2014

	2014			Total (Restated)
	Unrestricted (Restated)	Temporarily Restricted (Restated)	Permanently Restricted	
Revenue, gains and other support				
Contributions	\$ 11,613,144	\$ 2,282,641	\$ -	\$ 13,895,785
Museum sales (net of cost of goods sold of \$1,122,041)	1,246,707	-	-	1,246,707
Special events	231,795	-	-	231,795
In-kind support	176,874	359,490	-	536,364
Other revenue	264,356	-	-	264,356
Interest and dividends	215,332	41,024	-	256,356
Net assets released from restrictions	<u>5,271,565</u>	<u>(5,271,565)</u>	-	-
Total revenue, gains and other support	19,019,773	(2,588,410)	-	16,431,363
Expenses				
Program services	4,399,451	-	-	4,399,451
Program services - Heritage Center depreciation	<u>3,156,876</u>	-	-	<u>3,156,876</u>
Total program services	7,556,327	-	-	7,556,327
Fundraising	4,814,389	-	-	4,814,389
General and administrative	<u>976,453</u>	-	-	<u>976,453</u>
Total expenses	<u>13,347,169</u>	<u>-</u>	<u>-</u>	<u>13,347,169</u>
Change in net assets, before change in fair value of investments	5,672,604	(2,588,410)	-	3,084,194
Change in fair value of investments	<u>(19,245)</u>	<u>14,105</u>	<u>-</u>	<u>(5,140)</u>
Change in net assets	5,653,359	(2,574,305)	-	3,079,054
Net assets, beginning of year	<u>21,662,465</u>	<u>88,057,397</u>	<u>531,931</u>	<u>110,251,793</u>
Net assets, end of year	<u>\$ 27,315,824</u>	<u>\$ 85,483,092</u>	<u>\$ 531,931</u>	<u>\$ 113,330,847</u>

See accompanying notes to the financial statements.

Marine Corps Heritage Foundation
and Affiliate

Consolidated Statements of Cash Flows

	Years ended December 31,	
	2015	2014
Cash flows from operating activities		<i>(Restated)</i>
Change in net assets	\$ 9,022,491	\$ 3,079,054
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	3,277,800	3,424,613
Change in fair value of investments	(62,852)	5,140
Change in pledges allowance and discount	(253,776)	(1,294,736)
Change in agency fund investments	(7,775)	(7,579)
Donated marketable securities	-	(728,135)
Loss on disposal of fixed assets	37,487	359
Changes in operating assets and liabilities:		
Pledges receivable	2,966,600	6,067,203
Accounts receivable	858,961	(994,586)
Inventory	326,513	80,717
Prepaid expenses	33,055	859
Retirement plan assets	(32,144)	(41,741)
Accounts payable and accrued expenses	2,016,664	452,106
Retirement plan liability	32,144	41,741
Annuities payable	(1,140)	(1,140)
Net cash provided by operating activities	18,214,028	10,083,875
Cash flow from investing activities		
Increase in construction in progress	(11,949,787)	(6,124,431)
Purchases of investments	(20,539,729)	(10,181,513)
Proceeds from sales of investments	21,284,892	11,823,400
Additions to the Heritage Center	(3,235,941)	(176,914)
Purchases of fixed assets	(4,460)	(46,894)
Contributions and investment income restricted for the Heritage Center	(1,688,637)	(2,232,081)
Net cash used in investing activities	(16,133,662)	(6,938,433)
Cash flows from financing activities		
Contributions and investment income restricted for the Heritage Center	1,688,637	2,232,081
Principal payments on note payable	(519,796)	(12,000)
Agency funds	7,775	7,579
Net cash provided by financing activities	1,176,616	2,227,660
Net change in cash and cash equivalents	3,256,982	5,373,102
Cash and cash equivalents, beginning of year	10,972,673	5,599,571
Cash and cash equivalents, end of year	\$ 14,229,655	\$ 10,972,673

See accompanying notes to the financial statements.

Marine Corps Heritage Foundation and Affiliate

Notes to Consolidated Financial Statements

Years ended December 31, 2015 and 2014

Note A - Organization and Summary of Significant Accounting Policies

The Marine Corps Heritage Foundation (the Foundation) was established to preserve and promulgate the history, traditions and culture of the Marine Corps and educate all Americans in its virtues. The Foundation is registered as a non-profit organization in the Commonwealth of Virginia. In 2001, the Foundation commenced raising funds to build the Heritage Center and National Museum of the Marine Corps (the Museum) located in Quantico, Virginia. Ground was broken on Phase I construction in the spring of 2004 and the Museum opened in November 2006.

In addition to the Museum, the Foundation has also constructed a chapel, playground, roadway and walking pathways. In 2011, the Foundation initiated a second capital campaign to complete the Museum. Phase II of the Museum commenced construction in 2015 and is expected to end in 2017. The cumulative value of the Heritage Center, including the Museum, is reported on the Consolidated Statements of Financial Position in assets and temporarily restricted net assets.

The Foundation provides internships and fellowships for Marine Corps historical projects, sponsors award competitions, and provides program support to the History Division of Marine Corps University and the Museum.

The consolidated financial statements include the assets, liabilities and activities of the Heritage Center LLC (the LLC). The LLC was incorporated in Virginia on June 5, 2006 as a single member LLC, with the Foundation as the member. The LLC's operating agreement with the Foundation authorizes the LLC to operate revenue-producing units in the Museum, which include the Museum Store and other interactive venues. In February 2015, the LLC outsourced its retail operations to a third party vendor, which included an inventory acquisition. The LLC may distribute funds that were generated at the Museum to the Foundation to support the continued development of the Heritage Center and other Foundation programs. The LLC distributed to the Foundation \$760,000 and \$550,000 in 2015 and 2014, respectively.

The following is a summary of significant accounting policies followed in the preparation of these consolidated financial statements:

Principles of Consolidation

The consolidated financial statements include the accounts of the Foundation and the LLC (collectively referred to as the Foundation). Significant inter-company accounts and transactions have been eliminated in consolidation

Consolidated Financial Statement Presentation

The Foundation reports information regarding its consolidated financial position and activities using three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (Continued)

Basis of Accounting

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Accordingly, revenues are recognized when earned and expenses when the obligations are incurred.

Use of Estimates

GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events

The Foundation has performed an evaluation of subsequent events through April 15, 2016, which is the date the consolidated financial statements were available to be issued and has considered any relevant matters in the preparation of the consolidated financial statements and notes.

Reclassifications

Certain prior year amounts have been reclassified for comparative purposes to conform with the current year presentation. The reclassifications did not have an impact on the change in net assets or total net assets.

Income Taxes

The Foundation is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code and is not considered a private foundation. The Foundation is required to pay federal and state income taxes only on unrelated business income. The LLC is a disregarded entity, and is consolidated into the Foundation for tax reporting purposes. Management has concluded that the Foundation has maintained its tax exempt status and that there are no uncertain tax positions as of December 31, 2015.

Cash and Cash Equivalents

The Foundation considers cash and cash equivalents to include only demand deposits and savings accounts. Certificates of deposit and other short-term, highly liquid investments purchased for its portfolio are treated as investments rather than cash equivalents. The Federal Deposit Insurance Corporation (FDIC) insures amounts on deposit with each financial institution up to limits prescribed by law. The Foundation may hold funds with financial institutions in excess of the FDIC insured amounts; however, the Foundation has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on cash and cash equivalents.

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Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (Continued)

Inventory

Inventories are stated at lower of cost or market, with cost determined on a first-in, first-out basis. The Foundation identifies slow moving inventory on a quarterly basis for new inventory and an annual basis for long-term inventory. The Foundation will mark down slow moving inventory until sold off. In connection with the outsourcing of the retail operations in 2015, inventory was transferred or sold to the third party vendor or written off, resulting in no inventory at year end in 2015.

Investments and Fair Value Measurement

Investments are recorded at fair value, with interest, dividends, gains and losses included in the consolidated statements of activities. The change in fair value of investments includes gains and losses realized upon sales and unrealized resulting from fluctuations in market values of investments. Gains and losses realized upon sales are calculated using the average cost method. Within the investment accounts, the Foundation maintains a cash balance for future investment purchases.

In accordance with GAAP, the Foundation prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The levels of the hierarchy are as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets that the Foundation has the ability to access.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, for substantially the entire period, for the assets or liabilities and market-corroborated inputs.

Level 3 – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement.

The Foundation recognizes transfers between levels at the end of the reporting period and there were no transfers between levels during 2015 or 2014.

Risks and Uncertainties

The Foundation invests in various securities. These securities are exposed to a variety of risks, such as interest rates, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amount reported in the consolidated financial statements.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments

The carrying amounts including cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and current maturities of long-term borrowings approximate fair value because of the short maturity of these instruments. The carrying amount of long-term debt approximates fair value because the interest rates on these instruments fluctuate with market interest rates offered to the Foundation for debt with similar terms and maturities.

Fixed Assets

Furniture, equipment and leasehold improvements are recorded at cost, less accumulated depreciation. Depreciation expense is computed using the straight-line method over the estimated life of 3-10 years for furniture and equipment, while leasehold improvements are amortized over the life of the lease. Expenditures for maintenance and repairs are expensed as incurred; betterments which increase the value or materially extend the life of the related assets are capitalized.

Heritage Center

The Heritage Center consists of the National Museum of the Marine Corps, Memorial Chapel, Semper Fi Memorial Park, Heritage Center Parkway, Heritage Center Parkway Overlook, and the Playground. The Act stipulates that the Heritage Center is to be deeded over once all financial obligations have been met which is currently estimated to be 2022. Until the Heritage Center is deeded, net assets will be released as depreciation on the Heritage Center is taken.

These assets are depreciated on a straight-line basis over their estimated useful lives of 20 to 30 years. The Foundation capitalizes costs in accordance with the Foundation's established threshold, while expensing amounts incurred for routine repairs and maintenance.

The carrying value of the Heritage Center is periodically evaluated and adjusted for any perceived impairments in value. The amount of write-downs, if required, is charged to expense in the period the impairment is identified. Circumstances that could have a significant adverse effect on the value of the Heritage Center include a deficit in contributions necessary to maintain the property and fund new construction projects. During the years ended December 31, 2015 and 2014, there were no impairments recognized.

Construction in Progress

Costs associated with Phase II, which will include a theater, combat art gallery, exhibit galleries and administrative office space, have been capitalized and are included as construction in progress on the consolidated statements of financial position.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (Continued)

Restricted Net Assets

Donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions.

Contributions

Contributions and pledges are recorded when the donor makes a contribution or promise to give to the Foundation that is, in substance, unconditional. Foundation-owned life insurance policies are recorded as contributions when received and are carried at their cash surrender value.

Pledges Receivable

Pledges receivable that are expected to be collected within one year are reported net of any estimated uncollectible amounts. Pledges receivable that are due beyond one year are carried at the estimated present value of the future receipts based on their perceived collectability and aged outstanding balance and have been discounted using rates which range from .17% to 4.94%.

Allowance for Uncollectible Contributions

The Foundation has established an allowance for uncollectible pledges. Although variability is inherent in such estimates, management believes that the allowance provided in the financial statements is adequate, but largely dependent on economic conditions. When all collection efforts have been exhausted, the account is written off against the allowance for doubtful accounts.

Notes Payable

Fair value approximates carrying value, due to the interest rate pricing on notes payable. See Note I for information on the notes payable.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note B - Heritage Center Restatement

During 2015, the Foundation adopted and retroactively applied a depreciation policy for the Heritage Center, resulting in the restatement of the carrying value of the Heritage Center and related depreciation expense that were attributable to prior years.

Previously, the Foundation deferred depreciation on the Heritage Center based on future gifting requirements between the Department of Navy and the Foundation. The original intent of the Foundation was to gift completed portions of the Heritage Center once the loan was satisfied in 2011 in accordance with the gifting requirements. However, due to the restructuring of the existing loan beyond 2011 and the delayed construction of Phase II until 2015, it was determined that the transfer of the Heritage Center to the Department of the Navy would occur after Phase II construction is complete and no financial obligation remains. Construction is anticipated to be completed in 2017, with the fulfillment of the obligation by 2022. Given the significant change in gift date, the Foundation evaluated and determined the deferral of depreciation was no longer appropriate in light of the existing facts.

Accordingly, these financial statements contain adjustments to reflect the effects of this correction to an accounting policy in accordance with GAAP on the statement of financial position and statement of activities as of and for the year ended December 31, 2014 as reflected below. The beginning of year net assets were restated to reflect depreciation from 2006 through 2013.

<u>Financial Statement Line</u>	<u>2014 As previously reported</u>	<u>Adjustment</u>	<u>2014 restated</u>
<u>Statement of financial position impact</u>			
Heritage Center	<u>\$ 75,432,993</u>	<u>\$ (23,972,415)</u>	<u>\$ 51,460,578</u>
Net assets, end of year			
Unrestricted net assets	\$ 27,315,824	\$ -	\$ 27,315,824
Temporarily restricted net assets	109,455,507	(23,972,415)	85,483,092
Permanently restricted net assets	<u>531,931</u>	<u>-</u>	<u>531,931</u>
Total net assets, end of year	<u>\$ 137,303,262</u>	<u>\$ (23,972,415)</u>	<u>\$ 113,330,847</u>
<u>Statement of activity impact</u>			
Net assets released from restriction	<u>\$ 2,114,689</u>	<u>\$ 3,156,876</u>	<u>\$ 5,271,565</u>
Depreciation expense - Heritage Center	<u>\$ -</u>	<u>\$ 3,156,876</u>	<u>\$ 3,156,876</u>
Change in net assets			
Net assets, beginning of year	<u>131,067,332</u>	<u>(20,815,539)</u>	<u>110,251,793</u>
Net assets, end of year	<u>\$ 137,303,262</u>	<u>\$ (23,972,415)</u>	<u>\$ 113,330,847</u>

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Notes to Consolidated Financial Statements (Continued)

Note C - Pledges Receivable

Pledges receivable consist of the following at December 31:

	<u>2015</u>	<u>2014</u>
Amounts due in:		
Less than one year	\$ 5,582,394	\$ 5,753,851
One to five years	12,945,770	15,803,709
More than five years	<u>1,898,516</u>	<u>1,835,720</u>
Total pledges	20,426,680	23,393,280
Less allowance and discount	<u>(1,269,998)</u>	<u>(1,523,774)</u>
Pledges net of allowance and discount	<u>\$ 19,156,682</u>	<u>\$ 21,869,506</u>

During 2009, the Foundation received a commitment for \$10,000,000 of which, \$7,500,000 has been received and recognized as revenue. The remaining \$2,500,000 is subject to certain conditions and will be recognized in the consolidated financial statements when conditions have been met.

As of December 31, 2015 and 2014, approximately 1.7% and 2.3% of the total pledges, respectively, represent amounts from current Foundation Board members.

Note D - Investments and Fair Value Measurements

The Foundation's total return on investments for the years ended December 31 is comprised of the following:

	<u>2015</u>	<u>2014</u>
Realized gains	\$ 14,809	\$ 323,086
Unrealized gains (losses)	<u>48,043</u>	<u>(328,226)</u>
Change in fair value of investments	62,852	(5,140)
Interest and dividends	247,839	256,356
Investment advisory fees	<u>(7,900)</u>	<u>(13,498)</u>
Total investment return	<u>\$ 302,791</u>	<u>\$ 237,718</u>

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note D - Investments and Fair Value Measurements (Continued)

The following table is a summary of the Foundation's investments measured at fair value within the GAAP fair value hierarchy at December 31:

Class of Security	2015	2014	Fair Value Level
Mutual funds:			
Fixed income funds	\$ 2,720,684	\$ 627,358	Level 1
Balanced index fund	918,643	-	Level 1
Value equity	-	434,255	Level 1
International equity	-	1,050,173	Level 1
Growth equity	-	680,031	Level 1
Emerging markets	-	372,782	Level 1
Other	-	325,617	Level 1
	<u>3,639,327</u>	<u>3,490,216</u>	Level 1
Hedge funds & limited partnerships	<u>127,453</u>	<u>548,254</u>	Level 3
Total investments at fair value	3,766,780	4,038,470	
Cash and cash equivalents	<u>15,834,981</u>	<u>16,236,682</u>	
Total investments	<u>\$ 19,601,761</u>	<u>\$ 20,275,152</u>	

The certificates of deposits held by the Foundation do not meet the definition of securities under accounting standards and thus are not subject to the fair value disclosure requirements of GAAP. The Foundation's mutual funds are valued based on quoted market prices in active markets and therefore classified as Level 1 securities in accordance with GAAP.

The Foundation's use of Level 3 "unobservable inputs" includes its investments which consist primarily of two hedge funds (Funds), whose values are derived from the Fund's net asset value. One hedge fund was created to maximize risk-adjusted returns and achieve low correlation to the equity markets by investing in a diversified group of pooled investment vehicles. The second hedge fund was created to achieve superior risk-adjustment returns with low volatility and low correlation to both the equity and fixed income markets by investing in a diversified group of pooled investments vehicles. The hedge funds may invest in investment vehicles domiciled both within and outside the United States and the Foundation shall not be liable for the Fund's debts, obligations and liabilities in any amount in excess of the Foundation's capital balance. The Foundation may redeem some or all of its shares in the Funds as of the last business day of any calendar quarter. Written notice to redeem all or part of its capital interest must be received by the Funds at least sixty days prior to the date of redemption. Redemptions can be done in increments of \$10,000, provided that the greater of \$50,000 or twenty percent of the Foundation's initial investment remains in the Funds.

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Notes to Consolidated Financial Statements (Continued)

Note D - Investments and Fair Value Measurements (Continued)

Investments in the hedge funds are typically valued, as a practical expedient, utilizing the net asset valuations provided by the underlying private investment companies and or their administrators, without adjustment, when the net asset valuations of the investments are calculated in a manner consistent with GAAP for investment companies. The Foundation applies the practical expedient to its investments in alternative investments, unless it is probable that the Foundation will sell a portion of an investment at an amount different from the net asset valuation. If it is probable that the Foundation will sell an investment at an amount different from the net asset valuation or in other situations where the practical expedient is not available, the Foundation considers other factors in addition to the net asset valuation, such as features of the investment, including redemption rights in its determination of fair value.

The changes in Level 3 investments at fair value (hedge funds and limited partnerships) for the years ended December 31, 2015 and 2014 are summarized as follows:

Beginning balance, 2014	\$ 355,044
Purchases and settlements	172,603
Net investment gain	<u>20,607</u>
Ending balance, 2014	548,254
Purchases and settlements	(401,039)
Net investment loss	<u>(19,762)</u>
Ending balance, 2015	<u>\$ 127,453</u>

Retirement plan assets totaling \$207,766 and \$175,622 at December 31, 2015 and 2014, respectively, consist of mutual funds and equity securities which are classified as Level 1 securities in accordance with the GAAP fair value hierarchy.

The Foundation is aware of various split-interest agreements from donors where the Foundation may be listed as the beneficiary of future benefits. The Foundation is not able to obtain sufficient information for the determination of the related assets, liabilities, revenues, and changes in the fair value of the split-interest agreements over the term of the agreements. Accordingly, these are not recognized in the consolidated financial statements for the years ended December 31, 2015 and 2014.

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Notes to Consolidated Financial Statements (Continued)

Note E - Fixed Assets

Fixed assets of the Foundation consist of the following at December 31:

	<u>2015</u>	<u>2014</u>
Equipment and software	\$ 1,262,094	\$ 1,461,965
Office building	278,170	278,170
Furniture and fixtures	89,950	115,215
Leasehold improvements	117,227	117,227
Vehicles	<u>-</u>	<u>20,636</u>
	1,747,441	1,993,213
Accumulated depreciation	<u>(1,563,149)</u>	<u>(1,665,074)</u>
Fixed assets, net	<u>\$ 184,292</u>	<u>\$ 328,139</u>

Note F - Heritage Center

The Heritage Center consisted of the following at December 31:

	<u>2015</u>	<u>2014</u>
National Museum USMC	\$ 60,453,221	\$ 60,434,331
Semper Fi Memorial park	7,622,358	7,494,433
Memorial chapel	5,874,122	5,874,122
Heritage Center parkway overlook	2,347,504	-
Heritage Center parkway	1,874,592	1,132,970
Playground	<u>497,137</u>	<u>497,137</u>
	78,668,934	75,432,993
Accumulated depreciation	<u>(27,139,396)</u>	<u>(23,972,415)</u>
Heritage Center, net	<u>\$ 51,529,538</u>	<u>\$ 51,460,578</u>

Note G - Agency Funds

The Foundation is the agent for certain donor-advised trust funds held for the purpose of maintaining historical museum exhibits and offering awards to those preserving the history of women marines. These funds are included in the investments of the Foundation and also are shown as a liability since the Foundation functions only as an agent in the holding and disbursement of these funds. Investment income on these funds increases the asset and related liability, and is not included as part of investment income of the Foundation.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note H - Restricted Net Assets

Temporarily Restricted

Temporarily restricted net assets consist of funds to support various programs of the Foundation, including awards and fellowships, educational programs, and the development of the Heritage Center. Temporarily restricted net assets were released from donor restrictions by incurring expenses satisfying the purpose or time restrictions. Net assets released from restriction were as follows:

	<u>2015</u>	<u>2014</u>
Heritage Center expenses, including depreciation	\$ 4,449,397	\$ 4,656,462
Support programs	313,285	186,404
Awards and fellowships program	214,530	428,417
Monuments	11	282
Total assets released from restriction	<u>\$ 4,977,223</u>	<u>\$ 5,271,565</u>

At December 31, temporarily restricted net assets consisted of funds available for the following purposes:

	<u>2015</u>	<u>2014</u>
Heritage Center	\$ 82,134,985	\$ 84,796,349
Support programs	845,885	227,740
Awards and fellowships program	333,124	326,478
Monuments	133,514	132,525
Total temporarily restricted net assets	<u>\$ 83,447,508</u>	<u>\$ 85,483,092</u>

Endowment

The amounts classified as permanently restricted net assets in the consolidated statements of financial position represent the Foundation's endowment. The Board of Directors of the Foundation has interpreted Virginia's Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the original gift as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulation to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. Unless the original agreement states that earnings can be used for unrestricted purposes, endowment earnings are classified as temporarily restricted until such time that they are appropriated for use.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note H - Restricted Net Assets (Continued)

Investment Policy

The Foundation's endowment policy is focused on the preservation of capital and amounts can be invested in equities, mutual funds, fixed income securities and money markets.

Endowment Fund Composition and Related Activity

As required by GAAP, net assets associated with these funds are classified and reported based on the existence or absence of donor imposed restrictions. The endowment consisted of the following as of December 31:

	2015	2014
Temporarily restricted:		
Awards and fellowships	\$ 333,124	\$ 326,478
Support programs	-	36,877
	333,124	363,355
Permanently restricted:		
Awards and fellowships	431,931	431,931
Support programs	100,000	100,000
	531,931	531,931
Total endowment	\$ 865,055	\$ 895,286

The Endowment's fund activity as of and for the years ended December 31, 2015 and 2014 consisted of the following:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, December 31, 2013	\$ 348,578	\$ 531,931	\$ 880,509
Investment income	18,071	-	18,071
Net realized and unrealized loss	(945)	-	(945)
Total investment return	17,126	-	17,126
Appropriation for expenditure	(2,349)	-	(2,349)
Net assets, December 31, 2014	363,355	531,931	895,286
Investment income	16,124	-	16,124
Net realized and unrealized gain	1,455	-	1,455
Total investment return	17,579	-	17,579
Appropriation for expenditure	(47,810)	-	(47,810)
Net assets, December 31, 2015	\$ 333,124	\$ 531,931	\$ 865,055

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note I - Notes Payable

In November 2006, an agreement was signed that converted the original construction debt instrument of \$23 million into a term loan in the amount of \$15,700,000. This agreement also provided for an additional borrowing in the form of a revolving line of credit up to \$6,000,000 until the restructuring of the agreement in 2011.

The interest was assessed at the floating monthly LIBOR rate plus 1.0% and called for principal and interest payments every May 31 and November 30 beginning in May 2007 and ending on the maturity date of November 30, 2011. Prior to the November 2011 payoff, management restructured the loan to a \$1,000,000 term loan at the floating monthly LIBOR rate plus 2%. The new loan required monthly interest payments and a lump sum principal repayment of \$519,796 which was paid on June 3, 2015.

During the years ended December 31, 2015 and 2014, total interest costs incurred amounted to \$4,841 and \$11,501, respectively. All interest incurred since inception has been capitalized in relation to the construction of the Museum.

The Foundation entered into a loan agreement with Navy Federal Credit Union on April 13, 2015, to borrow up to \$20,000,000 for use in the construction of the National Museum of the Marine Corps, with a maturity date of April 13, 2022. Interest will accrue on the principal unpaid balance of this loan at the rate of 4.00% until April 13, 2017. After that time, interest will accrue on the unpaid balance at a rate of 3.50%, until paid in full. As of December 31, 2015, no drawdowns have occurred on this loan.

Note J - Charitable Gift Annuity

The Foundation received a total of \$20,000 in prior years from donors in order to establish charitable gift annuities. The charitable gift annuity agreements require the Foundation to make quarterly payments totaling \$285 to the donors for the remainder of the individuals' lives. The annuity agreements are not transferable and terminate at the donors' deaths. The difference between the initial gifts and the calculated annuity liabilities was recorded as contributions in the years received. As of December 31, 2015 and 2014, the Foundation had a liability for annuities of \$5,734 and \$6,874, respectively.

Note K - Retirement Plans

The Foundation provides a salary deferral arrangement which is qualified under Section 403(b) of the Internal Revenue Code. Employees may begin making elective contributions upon reaching age 21 and completing 90 days of service. The Foundation matches 50% of the amount deferred by participants. Benefits expense for the years ended December 31, 2015 and 2014 was \$81,654 and \$102,541, respectively.

Marine Corps Heritage Foundation
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Notes to Consolidated Financial Statements (Continued)

Note K - Retirement Plans (Continued)

The Foundation also sponsors a deferred compensation plan under IRC Section 457(b). Eligible employees may elect to have amounts, subject to statutory limits which are annually adjusted, withheld from their compensation and contributed to funds established for the employees' benefit. Deferred compensation assets held by the Foundation under the plan for which the employees are 100% vested total \$207,766 and \$175,622 for the years ended December 31, 2015 and 2014, respectively. The statements of financial position reflect an asset and corresponding liability, with the investment income and an offsetting expense recorded in the statement of activities.

In 2015, a deferred compensation plan under IRC Section 457(f) was established for certain executives. An amount totaling \$66,000 has been accrued and is reported in accrued expenses in the statement of financial position as of December 31, 2015. The amounts within this deferred compensation plan are subject to all claims of the Foundation's creditors.

Note L - Commitments

Operating Leases

During 2012, the Foundation entered into a non-cancellable operating lease agreement for office space in Dumfries, Virginia, which is set to expire on December 31, 2017. Minimum future rental payments under this non-cancellable operating lease as of December 31, 2015 are:

2016	\$	137,640
2017		<u>141,768</u>
Total	\$	<u><u>279,408</u></u>

Rent expense for the years ended December 31, 2015 and 2014 was \$140,235 and \$125,734, respectively.

Retail Operating Agreement

In January 2015, the Foundation entered into a lease and operating agreement with a third party provider (Provider) to operate the retail operations of the LLC, which commenced on February 1, 2015 for an initial term of six years, and the ability to renew for an additional five-year term. As part of the transaction, inventory held by the LLC was either purchased by the Provider; transferred to the Provider and held as consignment inventory, or written off during 2015. Inventory held on consignment by the Provider as of December 31, 2015 was approximately \$52,000 and is reflected in accounts receivable in the statement of financial position.

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Notes to Consolidated Financial Statements (Continued)

Note L - Commitments (Continued)

The agreement provides that the Provider will pay both a fixed and variable rent. The fixed rental income, referred to as the base rent is \$3,452 per month for the right to use the premises for purposes of retail concessions. The variable rental income is based on a percentage of gross receipts of sales on a three tiered basis, excluding any sales taxes, returns and other items as designated per the contract. The three tiers are: 15% of gross receipts up to \$2,000,000; 20% of gross receipts between \$2,000,000 and \$2,500,000; and 25% of gross receipts greater than \$2,500,000. Lastly, the Provider is to make a capital investment between \$80,000 and \$100,000 for improvements to the retail premises within the initial term of the agreement and between \$50,000 and \$75,000 within the first 24 months of the renewal term.

The agreement contains a clause that requires the Foundation to purchase directly from the third party provider any branded inventory that is not saleable should the agreement be terminated. As of the report date, the Foundation has no intentions to terminate the agreement.

Note M - Allocation of Joint Costs

The Foundation conducted activities which incurred joint costs for the distribution of direct-marketing fundraising appeals and program information. Total joint costs of \$1,938,934 included allocated amounts of \$523,512 to program services and \$1,415,422 to supporting services for the year ended December 31, 2015. Total joint costs of \$1,783,967 included allocated amounts of \$695,747 to program services and \$1,088,220 to supporting services for the year ended December 31, 2014.

Note N - In-Kind Support

In-kind support received by the Foundation is recorded at fair value and is reflected in the consolidated statements of activities as in-kind support and within each of the functional expense categories benefited (program, fundraising and general and administrative). Total in-kind support consisted of the following for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Unrestricted in-kind support:		
Legal services provided by a board member	\$ 39,041	\$ 176,874
	39,041	176,874
Temporarily restricted in-kind support:		
Google grant award for advertising	114,089	359,490
	<u>\$ 153,130</u>	<u>\$ 536,364</u>

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Consolidating Statement of Financial Position

	December 31, 2015			
	Foundation	Heritage Center, LLC	Reclassifications & Eliminations	Total
Assets				
Cash and cash equivalents	\$ 13,956,423	\$ 273,232	\$ -	\$ 14,229,655
Investments	19,601,761	-	-	19,601,761
Investment in LLC	430,049	-	(430,049)	-
Pledges receivable, net	19,156,682	-	-	19,156,682
Accounts receivable	62,617	89,191	-	151,808
Inventory	-	-	-	-
Due from Foundation	-	(4,878)	4,878	-
Prepaid expenses	82,480	5,480	-	87,960
Construction in progress	20,425,421	-	-	20,425,421
Heritage Center	51,529,538	-	-	51,529,538
Fixed assets, net	56,356	127,936	-	184,292
Cash surrender value of life insurance policies	121,354	-	-	121,354
Retirement plan assets	207,766	-	-	207,766
Deposits	9,189	-	-	9,189
Total assets	\$ 125,639,636	\$ 490,961	\$ (425,171)	\$ 125,705,426
Liabilities and net assets				
Liabilities:				
Accounts payable and accrued expenses	\$ 2,910,363	\$ 60,912	\$ -	\$ 2,971,275
Due to LLC	(4,878)	-	4,878	-
Notes payable	-	-	-	-
Annuities payable	5,734	-	-	5,734
Retirement plan liability	207,766	-	-	207,766
Agency funds	167,313	-	-	167,313
Total liabilities	3,286,298	60,912	4,878	3,352,088
Net assets:				
Unrestricted net assets	38,373,899	430,049	(430,049)	38,373,899
Temporarily restricted net assets	83,447,508	-	-	83,447,508
Permanently restricted net assets	531,931	-	-	531,931
Total net assets	122,353,338	430,049	(430,049)	122,353,338
Total liabilities and net assets	\$ 125,639,636	\$ 490,961	\$ (425,171)	\$ 125,705,426

**Marine Corps Heritage Foundation
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Consolidating Statement of Activities

Year ended December 31, 2015

	Foundation Unrestricted	Foundation Temporarily Restricted	Foundation Permanently Restricted	Foundation Total	Heritage Center, LLC Unrestricted	Reclassifications & Eliminations	Total
Revenues, gains and other support							
Contributions	\$ 14,748,160	\$ 2,775,202	\$ -	\$ 17,523,362	\$ 18,603	\$ -	\$ 17,541,965
Retail rental income	-	-	-	-	320,230	-	320,230
Museum sales	-	-	-	-	89,388	-	89,388
Less: cost of sales	-	-	-	-	(78,400)	-	(78,400)
Total gross profit on sales	14,748,160	2,775,202	-	17,523,362	349,821	-	17,873,183
Special events	-	-	-	-	208,760	-	208,760
In-kind support	39,041	114,089	-	153,130	-	-	153,130
Other income	8,054	-	-	8,054	258,507	-	266,561
Interest and dividends	229,418	18,421	-	247,839	-	-	247,839
Net assets released from restrictions	4,977,223	(4,977,223)	-	-	-	-	-
Total revenue, gains, and other support	20,001,896	(2,069,511)	-	17,932,385	817,088	-	18,749,473
Expenses							
Program services	2,766,462	-	-	2,766,462	600,099	-	3,366,561
Program services - Heritage Center depreciation	3,166,981	-	-	3,166,981	-	-	3,166,981
Total program services	5,933,443	-	-	5,933,443	600,099	-	6,533,542
Fundraising	2,184,922	-	-	2,184,922	-	-	2,184,922
General and administrative	1,030,158	-	-	1,030,158	41,212	-	1,071,370
Total expenses	9,148,523	-	-	9,148,523	641,311	-	9,789,834
Change in net assets before change in fair value of investments and LLC distribution	10,853,373	(2,069,511)	-	8,783,862	175,777	-	8,959,639
Change in fair value of investments	28,925	33,927	-	62,852	-	-	62,852
Losses of the LLC	(584,223)	-	-	(584,223)	-	584,223	-
Change in net assets before distribution	10,298,075	(2,035,584)	-	8,262,491	175,777	584,223	9,022,491
LLC distribution	760,000	-	-	760,000	(760,000)	-	-
Change in net assets	11,058,075	(2,035,584)	-	9,022,491	(584,223)	584,223	9,022,491
Net assets, beginning of year	27,315,824	85,483,092	531,931	113,330,847	1,014,272	(1,014,272)	113,330,847
Net assets, end of year	\$ 38,373,899	\$ 83,447,508	\$ 531,931	\$ 122,353,338	\$ 430,049	\$ (430,049)	\$ 122,353,338

Marine Corps Heritage Foundation
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Consolidated Statement of Functional Expenses
(with summarized amounts for 2014)

	Year ended December 31,				
	Program services	Fundraising	General and administrative	2015	2014 (Restated)
Accounting and auditing	\$ 79,271	\$ 18,174	\$ 11,043	\$ 108,488	\$ 111,544
Advertising	84,389	-	103,173	187,562	483,079
Awards	18,123	-	-	18,123	32,997
Bank charges	3,123	-	16,475	19,598	21,509
Bad debt	-	58,001	-	58,001	2,666,027
Catalog	-	-	-	-	12,643
Consulting	182,882	201,844	400	385,126	358,403
Credit card fees	29,035	23,930	23,930	76,895	125,104
Depreciation	96,811	8,713	5,295	110,819	267,737
Depreciation - Heritage Center	3,166,981	-	-	3,166,981	3,156,876
Direct marketing	523,512	1,085,803	329,619	1,938,934	1,783,967
Dues and subscriptions	5,323	1,038	567	6,928	2,864
Educational support	229,749	-	-	229,749	220,269
Facilities development	184,041	-	-	184,041	77,216
Gifts	-	-	6,039	6,039	7,534
Insurance	71,475	-	18,446	89,921	106,958
Investment fees	-	-	7,900	7,900	13,498
Loss on disposal of assets	-	-	37,487	37,487	359
Maintenance	49,330	15,662	15,662	80,654	69,637
Marketing	40,916	19,946	-	60,862	29,896
Meetings	1,576	-	32,069	33,645	39,204
Museum and historical support	389,254	-	-	389,254	430,682
Museum expenses - LLC	31,189	-	-	31,189	44,407
Office expense	6,528	1,250	12,052	19,830	47,170
Postage and shipping	3,413	8,837	5,196	17,446	67,110
Printing	2,429	5,577	616	8,622	16,527
Professional fees	40,816	579	4,940	46,335	201,668
Rent	51,036	52,049	37,151	140,236	125,735
Salaries, taxes, and benefits	904,391	609,694	391,890	1,905,975	2,384,411
Special events	164,962	-	-	164,962	192,485
Staff training	-	5,042	633	5,675	9,297
Taxes and licenses	11,258	10,690	2,911	24,859	33,164
Telephone and utilities	106,487	6,369	6,370	119,226	119,095
Temporary help	-	35,682	-	35,682	42,172
Travel	1,754	15,071	535	17,360	14,943
USMC Support	3,019	-	-	3,019	2,500
Website and internet	50,469	971	971	52,411	28,482
Total	\$ 6,533,542	\$ 2,184,922	\$ 1,071,370	\$ 9,789,834	\$ 13,347,169