PUGET SOUND PILOTS AND SUBSIDIARY

SPECIAL-PURPOSE CONSOLIDATED
FINANCIAL STATEMENTS
(MODIFIED ACCRUAL BASIS)

FOR THE YEARS ENDED
DECEMBER 31, 2016 AND 2015

PUGET SOUND PILOTS AND SUBSIDIARY

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Shannon & Associates LLP
Certified Public Accountants
Management Consultants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Puget Sound Pilots
Seattle, Washington

We have audited the accompanying special-purpose consolidated financial statements of Puget Sound Pilots (a voluntary association of sole proprietors and incorporated individuals) and Subsidiary which comprise the special-purpose consolidated statements of assets, liabilities and pilots' equity - modified accrual basis as of December 31, 2016 and 2015, and the related special-purpose consolidated statements of revenues, expenses and changes in pilots' equity - modified accrual basis and cash flows - modified accrual basis for the years then ended, and the related notes to the special-purpose consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these special-purpose consolidated financial statements in accordance with the modified accrual basis of accounting described in Note 1; this includes determining that the modified accrual basis of accounting is an acceptable basis for preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these special-purpose 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 audit to obtain reasonable assurance about whether the special-purpose consolidated financial statements are free from material misstatement.

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

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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 special-purpose consolidated financial statements referred to above present fairly, in all material respects, the assets, liabilities, and pilots' equity of Puget Sound Pilots and Subsidiary, as of December 31, 2016 and 2015, and its revenues, expenses and changes in pilots' equity, and cash flows for the years then ended, in accordance with the basis of accounting described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the special-purpose consolidated financial statements, which describes the basis of accounting. The special-purpose consolidated financial statements are prepared on the modified accrual basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

Restriction on Use

Our report is intended solely for the information and use of Puget Sound Pilots and the Puget Sound Pilotage Commission and is not intended and should not be used by anyone other than these specified parties.

Shannon & Associates, LLP

Kent, Washington
April 12, 2017

PUGET SOUND PILOTS AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF ASSETS, LIABILITIES AND PILOTS' EQUITY - MODIFIED ACCRUAL BASIS
DECEMBER 31, 2016 AND 2015

ASSETS

		2016	2015	Increase (Decrease)
1.	**CURRENT ASSETS**			
2.	Cash in banks	$ 1,741,856	$ 1,858,162	$ (116,306)
3.	Accounts receivable, net of allowance for doubtful accounts of $5,500 at each year end	2,421,042	2,665,394	(244,352)
4.	Prepaid expenses	113,486	96,211	17,275
5.	**TOTAL CURRENT ASSETS**	4,276,384	4,619,767	(343,383)
6.	**PROPERTY, BOATS AND EQUIPMENT**			
7.	Total building, boats, furnishings, and equipment	12,199,076	11,982,229	216,847
8.	Less accumulated depreciation and amortization	10,599,068	10,172,900	426,168
9.	**NET PROPERTY, BOATS AND EQUIPMENT**	1,600,008	1,809,329	(209,321)
10.	**OTHER ASSETS**			
11.	Loan fees, net of accumulated amortization of $4,728 and $3,323 as of 2016 and 2015	1,722	3,327	(1,605)
12.	**TOTAL ASSETS**	$ 5,878,114	$ 6,432,423	$ (554,309)

The accompanying notes are an integral part of these special-purpose consolidated financial statements.

PUGET SOUND PILOTS AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF ASSETS, LIABILITIES AND PILOTS' EQUITY - MODIFIED ACCRUAL BASIS
DECEMBER 31, 2016 AND 2015

LIABILITIES AND PILOTS' EQUITY

		2016	2015	Increase (Decrease)
13.	**CURRENT LIABILITIES**			
14.	Funds held in trust (See Note 3)	$ 74,438	$ 110,370	$ (35,932)
15.	Accrued taxes	38,474	41,653	(3,179)
16.	Retirement expense payable	352,772	342,338	10,434
17.	Current portion of long-term liabilities	334,983	339,750	(4,767)
18.	**TOTAL CURRENT LIABILITIES**	800,667	834,111	(33,444)
19.	**LONG-TERM LIABILITIES, net of current portion**	299,000	556,121	(257,121)
20.	**UNRECORDED LIABILITIES, COMMITMENTS AND CONTINGENCIES**	-	-	-
21.	**TOTAL LIABILITIES**	1,099,667	1,390,232	(290,565)
22.	**PILOTS' EQUITY**			
23.	December distributions payable to pilots	1,522,269	1,661,392	(139,123)
24.	Reserved for operations	750,000	750,000	-
25.	Reserved for working capital account	693,460	973,679	(280,219)
26.	Remainder of pilots' equity	1,812,718	1,657,120	155,598
27.	**TOTAL PILOTS' EQUITY**	4,778,447	5,042,191	(263,744)
28.	**TOTAL LIABILITIES AND PILOTS' EQUITY**	$ 5,878,114	$ 6,432,423	$ (554,309)

The accompanying notes are an integral part of these special-purpose consolidated financial statements.

PUGET SOUND PILOTS AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN PILOTS' EQUITY - MODIFIED ACCRUAL BASIS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016 Amount	2016 Percent	2015 Amount	2015 Percent
1. **PILOTAGE REVENUE**	$ 34,183,294	100.0 %	$ 32,881,003	100.0 %
2. **OPERATING EXPENSES**				
3. Seattle office operating expense and administrative overhead	9,789,222	28.6	10,002,012	30.4
4. Boat operating expense	1,828,644	5.3	1,695,680	5.2
5. Port Angeles station operating expense	498,628	1.5	521,300	1.6
6. **TOTAL OPERATING EXPENSES**	12,116,494	35.4	12,218,992	37.2
7. **TRANSPORTATION FEES PAID DIRECTLY TO PILOTS**	1,097,809	3.2	1,119,406	3.4
8. **NET INCOME FROM POOLED OPERATIONS**	20,968,991	61.3	19,542,605	59.4
9. **OTHER INCOME (EXPENSE)**				
10. Interest income and finance charges	48,843	0.1	29,965	0.1
11. Miscellaneous income	-	-	1,123	0.0
12. **TOTAL OTHER INCOME (EXPENSE)**	48,843	0.1	31,088	0.1
13. **BALANCE OF REVENUE POOL BEFORE DEDUCTIONS OF INDIVIDUAL PILOTS' BUSINESS EXPENSES**	21,017,834	61.4 %	19,573,693	59.3 %
14. **LESS PER DETAIL BELOW**				
15. Buy-ins and buy-outs, net	(280,219)		(161,320)	
16. All other payments to pilots	(21,001,359)		(19,124,049)	
17. **TOTAL DETAIL**	(21,281,578)		(19,285,369)	
18. **NET INCREASE (DECREASE) IN PILOTS' EQUITY**	(263,744)		288,324	
19. **BEGINNING PILOTS' EQUITY**	5,042,191		4,753,867	
20. **ENDING PILOTS' EQUITY**	$ 4,778,447		$ 5,042,191	

The accompanying notes are an integral part of these special-purpose consolidated financial statements.

PUGET SOUND PILOTS AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
MODIFIED ACCRUAL BASIS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

		2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
1.	Balance of revenue pool before deductions of individual pilots' business expenses	$ 21,017,834	$ 19,573,693
	Adjustments to reconcile balance of revenue pool to cash provided by operating activities:		
2.	Depreciation and amortization	427,772	373,309
3.	Decrease (increase) in net accounts receivable	244,352	(768,485)
4.	Decrease (increase) in prepaid expenses	(17,275)	4,082
5.	Increase (decrease) in other assets	-	(1,150)
6.	Increase (decrease) in funds held in trust (see Note 3)	(35,932)	8,576
7.	Decrease in comp day expense payable	-	(21,183)
8.	Increase (decrease) in accrued taxes	(3,179)	6,837
9.	Increase in retirement expense payable	10,434	44,287
10.	NET CASH PROVIDED BY OPERATING ACTIVITIES	21,644,006	19,219,966
CASH FLOWS FROM INVESTING ACTIVITIES			
11.	Purchase of property, boats, and equipment	(216,850)	-
CASH FLOWS FROM FINANCING ACTIVITIES			
12.	Principal payments on notes payable	(291,576)	(291,579)
13.	Proceeds from notes payable	29,692	20,900
14.	Proceeds (payments) from buy-in and buy-outs, net	(280,219)	(161,320)
15.	Payments to members	(21,001,359)	(19,124,049)
16.	NET CASH USED IN FINANCING ACTIVITIES	(21,543,462)	(19,556,048)
17.	**NET INCREASE (DECREASE) IN CASH**	(116,306)	(336,082)
18.	Cash at beginning of year	1,858,162	2,194,244
19.	Cash at end of year	$ 1,741,856	$ 1,858,162
Supplemental disclosure of cash flow information			
20.	Interest paid	$ 21,462	$ 17,660
Non-cash investing and financing transactions			
21.	Equipment purchased through long-term financing	$ -	$ 340,408

The accompanying notes are an integral part of these special-purpose consolidated financial statements.

NOTE 1.--NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Puget Sound Pilots (PSP) is a voluntary association of sole proprietors and incorporated individuals. Their mission is to ensure against the loss of lives, loss of or damage to property and vessels, and to protect the marine environment by maintaining efficient and competent pilotage service on out State's inland waters within the Puget Sound Pilotage District. They pilot vessels under licenses issued by the U.S. Coast Guard and the State of Washington. Business is conducted in accordance with the Pilotage Act of the State of Washington and specified in RCW 88.16. Revenues are dependent on the tariff set by the Washington State Board of Pilotage Commissioners and the level of maritime traffic on these waters. Customers are international and domestic companies that pay established rates to utilize pilotage services within Puget Sound.

Principles of Consolidation

The special-purpose consolidated financial statements (also referred to as special-purpose financial statements) include the accounts of PSP and Pilot Technology Services, LLC (PTS), a wholly-owned subsidiary. Total PTS expenses are included in Seattle operating expenses. All significant intercompany transactions and balances have been eliminated. Unless otherwise noted, PSP refers to the consolidated entity.

PSP has an agreement with PTS under which PTS, having expertise in the area of technological assistance and education to marine pilots, can provide equipment, educational, and related services to pilots licensed in the State of Washington. Under the terms of the agreement, PSP pays PTS for providing equipment (PPUs) and related services to the pilots. Further, under a second agreement, PTS pays PSP for the cost of certain administrative services.

The total (income) and expenses related to the PPUs of the combined entities for the years ended December 31, 2016 and 2015, were:

	2016	2015
Depreciation and amortization	$ 286,768	$ 286,768
Interest expense	9,502	16,367
Taxes - B&O	8,964	7,907
Taxes - Property	4,958	8,771
Administrative	1,015	194
Training lodging and per diem	-	(1,600)
Consulting Fees	-	1,825
Computer maintenance	54,792	51,473
	$ 365,999	$ 371,705

NOTE 1.--NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting and Reporting

The accompanying special-purpose consolidated financial statements have been prepared on the modified accrual basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. That basis differs from accounting principles generally accepted in the United States of America in that payments to vendors are recognized when paid instead of when goods or services are received. Also, payments to employees and the executive director for compensated absences (sick leave) are recognized when paid instead of when the leave is earned, and payments to pilots for compensated absences (vacation, comp and sick leave), retirement, major medical and redemption of member ownership interests (buy-outs) are recognized when paid rather than when the leave is earned or liability incurred. See Notes 6 and 10 for unrecorded liabilities.

Revenue Recognition

Pilotage revenue is recognized on the accrual basis of accounting when services are performed. Pilotage services are invoiced to their commercial customers in accordance with the tariff regulated by the Washington State Board of Pilotage Commissioners (WAC 363-116-300). The tariff is evaluated annually. The tariff is designed to cover current operating costs and liabilities and to provide competitive compensation for pilots.

Cash and Cash Equivalents

Cash in banks for purposes of the consolidated statements of cash flows, includes checking accounts, money market accounts, and certificates of deposit.

Accounts Receivable and Credit Policies

Accounts receivable are customer obligations due under trade terms requiring payment within 30 days from the invoice date. Accounts receivable are stated at the amount billed to the customer.

Finance charges are accrued at 1.5% monthly if payment is not made within the normal payment terms. Accounts over 90 days were $264,812 and $8,921 at December 31, 2016 and 2015, respectively.

PSP establishes an allowance for uncollectible trade accounts receivable based on historical collection experience and management's evaluation of collectability of outstanding accounts receivable.

NOTE 1.--NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, Boats, and Equipment

Building, boats, furnishings and equipment are carried at cost. Depreciation and amortization of these assets is provided by the straight-line method over the assets' estimated useful lives which range from 3 to 39 years.

Effective January 1, 2014, PSP instituted a policy under which expenditures of $5,000 or more representing major improvements, replacements or extension of useful lives of property, boats, furnishings and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. Major boat and engine repairs are expensed as incurred. Upon sale or retirement of property, boats, furnishings and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss is included in the results of operations. Depreciation and amortization for the years ended December 31, 2016 and 2015, was $427,772 and $373,309, respectively.

Other Assets

Loan fees are recorded at cost and amortized on the straight-line basis over the life of the loan.

Income Taxes

As a voluntary association of sole proprietors and incorporated individuals, the PSP files a US Partnership Return of Income, which is informational in nature. The income and expense of the PSP includes only items relating to the business of the PSP which pass on to the individual or corporate income tax returns of the pilots. Pilots are responsible for their own income, social security and Medicare taxes. Accordingly, no provision for federal income taxes is represented in the special-purpose consolidated financial statements.

PSP asserts on all filings with the Internal Revenue Service that it is a voluntary association of individual persons and corporations and is not a partnership for any purpose whatsoever, including taxation, per a 1954 IRS directive.

PSP measures and recognizes the implications of positions taken or expected to be taken in its tax returns on an ongoing basis in accordance with income tax guidance. PSP had no unrecognized tax benefits or liabilities and no adjustments to its financial position, results of operations or cash flows related to uncertain tax positions taken for the years ended December 31, 2016 and 2015. PSP is no longer subject to federal, state or local income tax examinations by tax authorities for years prior to 2013. If assessed, PSP recognizes penalties and interest associated with tax matters as part of operating expenses.

NOTE 1.--NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

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

Reclassifications

Certain reclassifications were made to the 2015 financial statement presentation in order to conform to the 2016 financial statement presentation.

NOTE 2.--PROPERTY, BOATS AND EQUIPMENT

Property, boats and equipment are summarized as follows:

	2016	2015
Port Angeles station building	$ 2,104,532	$ 2,095,254
Port Angeles station furnishings and equipment	153,542	153,542
Boat "Juan de Fuca"	3,229,434	3,229,434
Boat "Puget Sound"	3,718,327	3,718,327
Seattle office furnishings, furniture and equipment, including computers	1,756,010	1,548,441
Portable pilot units	1,141,572	1,141,572
Portable radio equipment	95,659	95,659
	12,199,076	11,982,229
Less accumulated depreciation and amortization	10,599,068	10,172,900
	$ 1,600,008	$ 1,809,329

NOTE 3.--FUNDS HELD IN TRUST - TRAINING SURCHARGE AND GRAYS HARBOR PENSION

Pilotage Commission Trust - Training Surcharge

PSP acts as a fiduciary agent for the Washington State Board of Pilotage Commissioners (Commission) and collects a training surcharge on behalf of the Commission. This fee is set by the Commission and is invoiced by PSP on a per-assignment basis. The funds are scheduled to be transmitted by PSP to the Commission on a monthly basis.

NOTE 3.--FUNDS HELD IN TRUST - TRAINING SURCHARGE AND GRAYS HARBOR PENSION (Continued)

Funds held in trust at December 31, 2016 and 2015, consisted of the following:

	2016	2015
Pilotage Commission Trust - training surcharge	$ 65,135	$ 101,225
Grays Harbor pensions payable	9,145	9,145
Miscellaneous	158	-
	$ 74,438	$ 110,370

Training surcharge detail for years ended December 31, 2016 and 2015, consisted of the following:

	2016	2015
Training surcharge billed to customers (excluded from Pilotage Revenue on Page 7)	$ 457,800	$ 623,865
Training surcharge collected from customers	474,155	612,855
Collected and due to Pilotage Commission at December 31, 2016	39,960	55,695
Billed and uncollected amounts due to Pilotage Commission at December 31, 2016	29,175	45,530

Grays Harbor Pension Payable

Following a public hearing on August 9, 2001, the Washington State Board of Pilotage Commissioners, by lawful motion, directed "that funds derived from the application of the Gray's Harbor Pilotage District tariff (Pension Charge) for the purposes of offsetting a proportionate share of pension expenses will be remitted to Puget Sound Pilots for payment to retirees of the Grays Harbor Pilotage District and that Puget Sound Pilots will include reporting of the revenue and expenses in their annual audited Financial Statements."

1. Grays Harbor Pilotage District Pension Charge revenue (included in Pilotage Revenue, Page 7) — $ 105,247

2. Grays Harbor Pilotage District Pension expense (included in Seattle Office Operating Expense and Administrative Overhead, Page 7) — $ 109,739

   Detail of Grays Harbor Pension Expense

   a. Mrs. N. Dietrich $ 13,318
   b. Capt. J.M. Hoyne 39,010
   c. Capt. B. Watson 57,411

NOTE 4.--LONG-TERM LIABILITIES

Long-term liabilities at December 31, 2016 and 2015, consisted of the following:

	2016	2015
PPU note payable to bank secured by PSP assets bearing interest at 1.50% plus the lender's cost of funds (total rate of 2.34% at December 31, 2016 and 2015), monthly payments of $24,298 beginning November 1, 2013, maturing November 1, 2017.	$ 242,983	$ 534,563
Dispatch software note payable to bank secured by PSP assets bearing interest at 1.50% plus the lender's cost of funds at December 31, 2016, and 1.25% plus the one-month Libor rate at December 31, 2015 (total rate of 3.16% and 1.69% at December 31, 2016 and 2015, respectively), monthly payments of $6,022 beginning May 1, 2016, maturing April 1, 2021.	391,000	361,308
	633,983	895,871
Less current portion	334,983	339,750
Total long-term liabilities	$ 299,000	$ 556,121

PTS obtained the PPU note payable described above for the purchase of certain equipment and services. PSP is guarantor on the note. Generally, all the assets of PSP and PTS serve as collateral for the borrowing. The terms of the loan require PSP, as a guarantor, to meet certain covenants. Those covenants include maintaining cash and marketable securities having a value of at least $500,000 and a minimum increase of $1 in the pilot's equity measured at the fiscal year end. The agreement also requires PSP to provide periodic and annual financial statements prepared in accordance with generally accepted accounting principles. The bank has been provided with these special-purpose consolidated financial statements prepared in accordance with the modified accrual basis of accounting.

PSP obtained a term note for the dispatch software note payable described above. The loan allows for draws up to $460,000 up to the conversion date which was April 1, 2016. At the conversion date, the interest rate is the lender's cost of funds plus 1.5%. Generally all of the assets of PSP serve as collateral for the borrowing.

Total interest expense on all borrowings was $21,462 and $17,660 for the years ended December 31, 2016 and 2015.

NOTE 4.--LONG-TERM LIABILITIES (Continued)

Estimated future maturities of notes payable are as follows:

Years ending December 31,	
2017	$ 334,983
2018	92,000
2019	92,000
2020	92,000
2021	23,000
Thereafter	-
	$ 633,983

NOTE 5.--LINE OF CREDIT

PSP has a line of credit with a bank in the amount of $500,000 due September 30, 2017. There was no balance outstanding at December 31, 2016 and 2015. The agreement requires PSP to maintain cash and marketable publicly traded securities with a value of at least $500,000 as of the last day of each quarter. Accounts, equipment, and other assets were security for the line. The agreement also requires PSP to provide periodic and annual financial statements prepared in accordance with generally accepted accounting principles. The bank has been provided with these special-purpose consolidated financial statements prepared in accordance with the modified accrual basis of accounting.

NOTE 6.--RETIREMENT PLANS AND UNRECORDED LIABILITY - PILOTS AND FORMER EXECUTIVE DIRECTOR

A retirement program, identified as Plan 1, was adopted in 1982 and most recently amended in August 2006. The program provides each retired pilot and a former executive director an annual income (paid monthly) of 1.50% of the average of the final three years Target Net Income, as established by the Pilotage Commission (or actual average net income for any year in which there is no target net income) multiplied by the number of years of service.

Pilots who retired between December 31, 1978, and December 31, 1981, participate in a retirement plan known as the “Retirement Agreement of 1978.” Members who retired prior to that date participate in a lesser plan known as the “Trust Contract.” Surviving spouses of members receive a benefit equal to 50% of the member’s entitlement.

As part of an agreement with the Pilotage Commission, PSP is paying retirement benefits for the retirees of the Grays Harbor Bar Pilots. The cost was originally offset in part by a 2001 tariff increase of $8.00 in the LOA rate as well as a Grays Harbor pension charge of $463 per assignment (effective January 1, 2016) and $362 per assignment (effective August 1, 2014), respectively, paid by the Port of Grays Harbor to PSP. See also Note 3.

NOTE 6.--RETIREMENT PLANS AND UNRECORDED LIABILITY - PILOTS AND FORMER EXECUTIVE DIRECTOR (Continued)

Retirement payments are made from currently earned PSP income. There is no fund for satisfaction of future retirement income; and at December 31, 2016 and 2015, there were no assets set aside and available for future benefits. From 1967 to 2006, the Commission reimbursed the annual ongoing cost of the pilot retirement plans with funds from the tariff. Since then, the Commission has taken the added cost of the retirement plan into account when setting the tariff. Management believes the Commission will continue to provide adequate funds, directly or indirectly, in the tariff for the annual funding of the retirement plan expense. An estimate of the unfunded retirement program liability as of December 31, 2016 and 2015, has not been determined. See Note 10 for further discussion of unrecorded liabilities.

NOTE 7.--RETIREMENT PLANS - EMPLOYEES

Eligible employees are members of the Inlandboatmen's Union of the Pacific (Union). The Union sponsors a contributory 401(k) plan so that employees may contribute a portion of their pretax income into a retirement plan. All Union employees are eligible to participate upon commencing employment. PSP does not sponsor or contribute to the Union's 401(k) plan. See Note 11 for Union pension information.

In December 2015, PSP set up a 401(k) plan for all non-union employees. The plan allows for elective deferrals and provides a safe harbor match and discretionary profit sharing contribution. PSP contributions to the Plan for 2016 and 2015 were $28,452 and $9,246, respectively.

NOTE 8.--LEASES

Port Angeles Station

A building serving as a boarding and boat station is constructed on tidelands leased from the State of Washington. PSP has a lease with the State of Washington Department of Natural Resources that expires June 2021. The lease contains an 8-year renewal option. Rent expense related to this lease for 2016 and 2015 was $4,001 and $3,679, respectively.

Seattle Office

The dispatching and management headquarters is leased for seven years ending October 31, 2019, and has a five-year extension option. The lease has annual increases in rental rate per square foot. Rent is expensed as incurred and not amortized ratably over the lease term. Rent expense related to this lease for 2016 and 2015 was $99,320 and $95,456, respectively.

NOTE 8.--LEASES (Continued)

The following is a schedule of future minimum lease payments for non-cancelable operating leases with a term greater than one year as of December 31, 2016:

Years ending December 31,	
2017	$ 87,643
2018	89,719
2019	76,933
2020	3,685
2021	1,843
Thereafter	-
	$ 259,823

Total Leases

Total rent expense for all leases including parking, which is on a month-to-month agreement, was $121,846 and $117,636 for 2016 and 2015.

NOTE 9.--CONCENTRATIONS

PSP maintains cash balances in certain financial institutions that may, at times, exceed limits insured by the FDIC.

PSP does not believe that it is exposed to significant credit risk on cash and cash equivalents as deposits are maintained in high quality financial institutions and PSP has not experienced any losses in such accounts.

PSP derives its income from services performed within Puget Sound waters. Any disruption of ship travel within this region may significantly affect revenues and services.

NOTE 10.--UNRECORDED LIABILITIES

As noted in Note 1, these special-purpose financial statements are prepared on the modified accrual basis of accounting. This method of accounting and reporting permits PSP to present these special-purpose consolidated financial statements without recording the related liability for goods and services received but not paid, employee services earned but not paid, and the various pilot services earned but not paid. Thus, PSP is on a "pay-as-you-go" basis for most liabilities.

Had PSP recorded the present value of these future obligations at the time the goods were received, services performed or liability incurred, at the respective balance sheet dates, PSP would report in these financial statements a deficiency of assets, i.e., liabilities would exceed assets and thus pilots' equity would be negative (line 27, page 6).

NOTE 10.--UNRECORDED LIABILITIES (Continued)

The following are unrecorded liabilities at December 31, 2016 and 2015:

Individual pilots earn respite time in paid days for working engagements during the two-week off part of their two-week on (duty)/two-week off (respite) watch periods. In addition, members receive a two-week vacation each year. Whenever the volume of shipping requires, members on respite or vacation may perform assignments during their off duty and be credited with a comp day.

Comp day value at December 31, 2016, was approximately $6,206,368 compared with approximately $4,985,068 at December 31, 2015.

Annual unpaid vacation value at December 31, 2016, was approximately $1,018,326 compared with approximately $926,526 at December 31, 2015.

Historical experience indicates that some members receive comp day pay in the periods immediately after the end of their pilotage service. Historically, when setting the tariff, the Commission has considered pilots using comp days under these circumstances to be active pilots for purposes of determining how many pilots the tariff needs to fund.

Currently, PSP treats these payments to pilots without a license as an operating expense. Historically, funds to pay the cost to PSP of these comp days have been provided by the tariff. Management has no reason to believe that this will change in the future. In addition, the value of a comp day is directly related to the earnings of an active pilot (balance of pilotage revenue pooled per pilot). If those earnings decline, the value of the comp day - and the amount of the unrecorded liability associated with it - goes down by the same amount.

PSP's major medical plan provides for a continuation of full-share distributions for up to six watches to pilots who, due to illness or injury, are physically unable to pilot. During 2015, 5.6 monthly payments were made to different pilots under this operating rule. There were none during 2016. An estimate of the liability for major medical as of December 31, 2016 and 2015, has not been determined.

As pilots retire, PSP buys them out over a period of time. As of December 31, 2016 and 2015, the amount due to retired pilots under the buyout is approximately $3,340,809 and $3,785,415, respectively.

NOTE 10.-UNRECORDED LIABILITIES (Continued)

Redemption of pilot ownership interest for pilots being paid out as of December 31, 2016, due for each of the next five years and in the aggregate are as follows:

Years ended December 31,	
2017	$ 968,681
2018	835,341
2019	707,337
2020	557,604
2021	252,110
Thereafter	19,736
	$3,340,809

All Union employees earn vacation and sick leave in accordance with the Union contract. Employees are entitled to 6 days of sick leave per year and may only carry forward a maximum of 45 days.

The Executive Director earns vacation and sick leave in accordance with their contract. Unused sick leave may carryover from one year to another and may accrue up to a maximum of 90 days. An estimate of the liability for employee and Executive Director compensated absences as of December 31, 2016 and 2015, has not been determined.

NOTE 11.-COMMITMENTS AND CONTINGENCIES

In October 2011, PSP signed a labor agreement with the Inlandboatmen's Union of the Pacific which was effective from January 1, 2011, to December 31, 2015. The contract was extended through April 30, 2017.

PSP contributes to the Union's Trust, the purpose of which is to provide for hospital, medical, dental, vision care, time loss and life insurance benefits for all Union employees. Contributions to the Trust were $275,856 and $285,758 for the years ended December 31, 2016 and 2015, respectively, and are recorded on the cash basis in the accompanying special-purpose consolidated financial statements.

PSP also contributes to the Union's Trust, the purpose of which is to provide pensions and annuities for the benefit of employees who qualify under the provisions of the Union's retirement plan (Inlandboatmen's Union of the Pacific National Pension Plan) and to provide benefits to the beneficiaries of the employees. Contributions to the trust were $121,897 and $129,035 for the years ended December 31, 2016 and 2015, respectively, and are recorded on the cash basis in the accompanying special-purpose consolidated financial statements. Contributions include supplemental contributions under the Rehabilitation Plan adopted by the Union of .05% per year.

NOTE 11.-COMMITMENTS AND CONTINGENCIES (Continued)

Under the terms of the Union contract, PSP makes "defined contributions" and not "defined benefits." PSP does not consent to the existence or maintenance of any funding deficiency. Accordingly, PSP's liability is limited to the making of contributions as prescribed by the agreement.

NOTE 12.-SUBSEQUENT EVENTS

Management has evaluated subsequent events through April 12, 2017, the date which the financial statements were available to be issued.