

# The Mariners' Museum

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## Financial Statements

Year Ended September 30, 2015

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## **Independent Auditors' Report**

Board of Trustees  
The Mariners' Museum  
Newport News, Virginia

We have audited the accompanying financial statements of The Mariners' Museum, which comprise the statements of financial position as of September 30, 2015, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

### ***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.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 entity'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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of The Mariners' Museum as of September 30, 2015, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Dixon Hughes Goodman LLP*

**Newport News, Virginia  
March 28, 2016**

**The Mariners' Museum**  
**Statement of Financial Position**  
**September 30, 2015**

**ASSETS**

Current assets

Cash and cash equivalents - operating accounts	\$ 757,289
Accounts receivable	207,838
Current portion of pledges receivable (Note 3)	585,956
Inventories	233,892
Other current assets	<u>52,249</u>

Total current assets 1,837,224

Property and equipment - net (Note 5) 29,203,816

Other assets

Investments

Cash and cash equivalents - investment accounts	19,904,211
Investments (Note 4)	813,047
Beneficial interest in trusts (Note 6)	83,197,097
Pledges receivable - less current portion (Note 3)	<u>385,000</u>

Total other assets 104,299,355

\$ 135,340,395

**LIABILITIES AND NET ASSETS**

Current liabilities

Accounts payable	\$ 158,845
Accrued expenses	<u>441,324</u>

Total current liabilities 600,169

Long-term liabilities

Charitable gift annuities (Note 8)	66,715
Bond payable (Note 10)	9,600,000
Deferred revenue (Note 9)	<u>6,200,794</u>

Total liabilities 16,467,678

Net assets

Unrestricted	32,690,084
Temporarily restricted (Note 11)	2,661,365
Permanently restricted (Note 11)	<u>83,521,268</u>

Total net assets 118,872,717

\$ 135,340,395

**The Mariners' Museum**  
**Statement of Activities**  
**Year Ended September 30, 2015**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenue, gains and support				
Income from funds held in trust by others	\$ 4,250,792	\$ -	\$ -	\$ 4,250,792
Contributions	694,506	1,075,675	-	1,770,181
Admission fees	510,229	-	-	510,229
Miscellaneous	302,762	18,010	(9,384)	311,388
Museum shop	182,047	-	-	182,047
Facility rental	159,655	-	-	159,655
Lease	141,410	-	-	141,410
Dividend and interest income - net	66,051	40,619	1,236	107,906
Education program fees	94,638	-	-	94,638
Grants	-	92,578	-	92,578
Chris Craft	28,279	-	-	28,279
Photography	26,754	-	-	26,754
Publications	15,896	-	-	15,896
Deaccession	7,768	-	-	7,768
Boat house	3,383	-	-	3,383
Realized and unrealized losses on investments - net	(58,268)	(56,300)	(6,557,262)	(6,671,830)
Net assets released from restrictions	957,905	(698,413)	(259,492)	-
<b>Total revenue, gains and support</b>	<b><u>7,383,807</u></b>	<b><u>472,169</u></b>	<b><u>(6,824,902)</u></b>	<b><u>1,031,074</u></b>
Program expenses				
Curatorial and conservation	643,742	-	-	643,742
Marketing and special events	548,686	-	-	548,686
Admissions	500,891	-	-	500,891
Library and archives	307,199	-	-	307,199
Collection management	319,760	-	-	319,760
Education	319,347	-	-	319,347
Exhibit design and production	289,245	-	-	289,245
Museum shop	159,812	-	-	159,812
Photography	135,484	-	-	135,484
Park and Noland Trail	69,461	-	-	69,461
Publications and graphic design	36,915	-	-	36,915
Chris Craft	26,389	-	-	26,389
Facilities management	10,447	-	-	10,447
<b>Total program expenses</b>	<b><u>3,367,378</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>3,367,378</u></b>
Supporting expenses				
General administration	3,669,690	-	-	3,669,690
Facilities management	2,052,645	-	-	2,052,645
Development and membership	503,097	-	-	503,097
Museum shop	8,411	-	-	8,411
<b>Total supporting expenses</b>	<b><u>6,233,843</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>6,233,843</u></b>
<b>Total expenses</b>	<b><u>9,601,221</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>9,601,221</u></b>
Change in net assets	(2,217,414)	472,169	(6,824,902)	(8,570,147)
Net assets - beginning of year	34,907,498	2,189,196	90,346,170	127,442,864
Net assets - end of year	<u>\$32,690,084</u>	<u>\$ 2,661,365</u>	<u>\$83,521,268</u>	<u>\$ 118,872,717</u>

See accompanying notes and independent auditors' report.

**The Mariners' Museum**  
**Statement of Cash Flows**  
**Year Ended September 30, 2015**

Cash flows from operating activities	
Change in net assets	\$ (8,570,147)
Adjustments to reconcile to net cash from operating activities:	
Depreciation	1,728,565
Change in discount for uncollectible pledges	(25,063)
Unrealized losses on investments:	
Funds held in trust by others	6,554,040
Investments	117,790
Change in valuation of charitable gift annuities	9,384
Change in:	
Accounts receivable	(197,867)
Pledges receivable	552,579
Inventories	6,250
Other current assets	106,317
Accounts payable	(21,436)
Accrued expenses	11,217
Deferred revenue	122,254
Net cash from operating activities	<u>393,883</u>
Cash flows from investing activities	
Property and equipment acquisitions	(244,886)
Maturities of certificates of deposit	1,389,228
Sales and maturities of investments	16,224,247
Purchases of investments	<u>(879,134)</u>
Net cash from investing activities	<u>16,489,455</u>
Cash flows from financing activities	
Payments on charitable gift annuities	<u>(19,476)</u>
Net change in cash and cash equivalents	16,863,862
Cash and cash equivalents - beginning of year	<u>3,797,638</u>
Cash and cash equivalents - end of year	<u>\$ 20,661,500</u>
Cash and cash equivalents - end of year:	
Held in operating accounts	\$ 757,289
Held in investment accounts	<u>19,904,211</u>
Cash and cash equivalents - end of year	<u>\$ 20,661,500</u>
Supplemental disclosure of cash flow information	
Cash paid for interest	<u>\$ 262,260</u>

See accompanying notes and independent auditors' report.

## **Notes to Financial Statements**

### **1. Organization and Nature of Activities**

The Mariners' Museum (Museum) is a Virginia nonprofit educational and cultural institution which was incorporated in May 1930, and is located in Newport News, Virginia.

The stated mission of The Mariners' Museum and Park is to connect people to the world's waterways through exploration and engaging experiences. The Mariners' Museum uses its art and artifacts to educate local, national and international audiences of all ages about the vital role of the sea in mankind's development. The Museum aspires to be the leader in promoting an appreciation of the maritime world - past, present and future. The Mariners' Museum Park and Lake Maury offer the residents of and visitors to the area the opportunity to experience the beauty and peace of an oasis in the city, to enjoy healthy exercise on the Noland Trail and to enhance their appreciation of the natural habitat of the park.

During 2014, the Museum elected to change its fiscal year end from December 31 to September 30. The fiscal year was changed to better monitor the Museum's revenue cycle and was approved by the Board of Trustees effective January 1, 2014.

### **2. Summary of Significant Accounting Policies**

#### ***Accounting Method***

The financial statements of the Museum have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America; revenue and gains are recognized when earned, and expenses and losses are recognized when incurred. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.

#### ***Basis of Presentation***

The financial statements report amounts separately by classes of net assets.

**Unrestricted** amounts are those currently available at the discretion of the Museum's Board of Trustees for use in operations and those resources invested in property and equipment.

**Temporarily restricted** amounts are those which are stipulated by donors for specific operating purposes or for the acquisition of property and equipment. When a donor restriction is satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

**Permanently restricted** amounts are those donated with a stipulation that they be invested to provide a permanent source of revenue. Such revenue is expendable in accordance with the conditions of each specific donation.

All contributions are considered available for unrestricted use unless specifically restricted by the donor or subject to other legal restrictions.

#### ***Cash and Cash Equivalents***

The Museum considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

**The Mariners' Museum**  
**Notes to Financial Statements**

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***Inventories***

Inventories consist of gift shop items and publications and are stated at the lower of cost (determined using the first-in, first-out method) or market. Inventory related to the Museum Shop was \$190,658 at September 30, 2015, and publications inventory was \$47,957 at September 30, 2015. At September 30, 2015, a valuation allowance of \$4,723 was recorded for slow-moving publications inventory.

***Investments***

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Fair value is 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. See Note 12 for discussion of fair value measurements. Investment distribution or loss (including gains and losses on investments, interest and dividends) is included in the statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

Beneficial interest in trusts represent resources neither in the possession nor under the control of the Museum, but held and administered by outside fiscal agents, with the Museum deriving income from such funds. The trusts are stated at fair value. The assets held in trust are classified as permanently restricted. The distribution received from the trusts is classified as increases in unrestricted net assets in the accompanying statement of activities. Unrealized gains or losses of the assets held by the trusts are reflected as a change in permanently restricted net assets on the accompanying statement of activities.

***Property and Equipment***

Property and equipment are stated at cost on acquisition date or fair value on gift date. Property and equipment, except land and lakes, dams and improvements, are depreciated by the straight-line method over their estimated useful lives as follows:

	<u>Years</u>
Building and improvements	5 - 59
Furniture and equipment	2 - 20
Land improvements	10 - 20
The Noland Trail	20

Maintenance and ordinary repairs are expensed; improvements are capitalized. Gains and losses arising from disposal or retirement of property and equipment are recognized currently in the accompanying statement of activities and the cost and related accumulated depreciation, if applicable, are removed from the accounts. For donated capital assets, the Museum does not impose a restriction on the length of time the assets must be held. The Museum's policy is to capitalize all items with a useful life greater than one year.

***Collection***

The Museum maintains significant collection assets, including models, small crafts, prints, paintings, books, photographs, and navigation instruments. In accordance with industry practice, the value of the collection has been excluded from the statement of financial position. Only current year purchases and proceeds from sale are reflected in the statement of activities. It is the policy of the Museum that proceeds from the sale of any collection items are to be used for the acquisition of objects for the permanent collections or for the conservation or maintenance of items currently owned by the Museum by external conservators.

***Pledges Receivable***

Pledges receivable are recognized as revenue in the period the promise is made by the donor. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved when deemed significant. An allowance for uncollectible pledges receivable is provided based upon management's judgment, including such factors as prior collection history and type of pledge.



**The Mariners' Museum  
Notes to Financial Statements**

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***In-Kind Contributions and Donated Services***

The Museum received in-kind contributions of \$313,815 in 2015. These contributions were primarily related to artifacts. Additionally, the Museum received volunteer hours of 20,470 in 2015. No amounts have been recognized in the statement of activities for donated services because the criteria for recognition under applicable accounting standards have not been satisfied.

***Restricted Contributions***

Contributions received by the Museum with donor-imposed temporary restrictions, which are not met within the same reporting period, are reported as temporarily restricted revenues. The revenue is then shown as released from restrictions on the accompanying statement of activities when the restriction has been satisfied. Donor-restricted contributions whose restrictions are met in the same period are reported as unrestricted support.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

***Functional Expenses***

The Museum allocates its expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are allocated directly. Other expenses that are common to several functions are allocated by various statistical bases.

***Advertising Costs***

Advertising costs are expensed as incurred and were \$347,330 for 2015 and is included in marketing and special events and admissions expense on the statement of activities.

***Income Taxes***

The Museum is a nonstock corporation which has been determined by the Internal Revenue Service to be exempt from taxes on income derived from activities related to its exempt purpose under Section 501(c)(3) of the Internal Revenue Code. The Museum is subject to income taxes on profits, if any, generated from the sale of items in its gift shop which are unrelated to its exempt purpose. The Internal Revenue Service has also determined that the Museum is not a private foundation under Section 509(a)(1).

***Credit Risk***

Financial instruments that potentially expose the Museum to concentrations of credit risk consist primarily of cash and cash equivalents and investments. Cash and cash equivalents and investments are maintained at high quality financial institutions. At September 30, 2015, the Museum had approximately \$20.1 million of cash and cash equivalents on deposit with financial institutions in excess of the Federal Deposit Insurance Corporation (FDIC) limit, most of which was held in the investment accounts and will be invested over time.

***Subsequent Events***

In preparing these financial statements, the Museum has evaluated events and transactions for potential recognition or disclosure through March 28, 2016, the date the financial statements were available to be issued.

**The Mariners' Museum**  
**Notes to Financial Statements**

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**3. Pledges Receivable**

The Museum records pledges receivable as income in the year the promise is received. Pledges receivable have the following restrictions:

The Monitor Center campaign	\$ 858,277
General operating and library support	112,679
	<u>970,956</u>
	<u>\$ 970,956</u>

The anticipated cash flows from pledges receivable is as follows:

Receivable in less than one year	\$ 585,956
Receivable in one to five years	570,000
Total pledges receivable	1,155,956
Less - allowance for uncollectible pledges	(185,000)
	970,956
Less - current portion	(585,956)
	<u>385,000</u>
	<u>\$ 385,000</u>

**4. Investments**

Investments are presented at fair value and consist of the following:

Equity securities - US Large Cap	\$ 727,946
Equity securities - Non US	35,336
Mutual funds - equity - other	49,765
	<u>813,047</u>
	<u>\$ 813,047</u>

The investments are under the management of JP Morgan Chase Bank and Wells Fargo Advisors, LLC, who also maintain custody of the securities. The Museum's investments are primarily in equity securities and investment income is reported in the accompanying statement of activities, net of investment management fees. At September 30, 2015, \$19,904,211 of cash and cash equivalents is held in the JP Morgan Chase Bank investment accounts and will be invested over time.

At September 30, 2015 fair values and unrealized gains are summarized as follows:

	Cost	Fair Value	Unrealized Gain
JP Morgan Chase Bank	\$ 745,653	\$ 763,282	\$ 17,629
Wells Fargo Advisors, LLC	49,366	49,765	399
	<u>795,019</u>	<u>813,047</u>	<u>18,028</u>
	<u>\$ 795,019</u>	<u>\$ 813,047</u>	<u>\$ 18,028</u>

**The Mariners' Museum**  
**Notes to Financial Statements**

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**5. Property and Equipment**

Property and equipment consist of the following:

Building and improvements	\$ 50,879,757
Furniture and equipment	6,540,778
Land improvements	4,656,952
The Noland Trail	2,219,802
Lakes, dams and improvements	626,901
	<u>64,924,190</u>
Less - accumulated depreciation	(35,738,360)
	<u>29,185,830</u>
Construction in progress	17,986
	<u>\$ 29,203,816</u>

Depreciation expense for 2015 was \$1,728,565.

**6. Beneficial Interest in Trusts**

The Museum is the beneficiary of various irrevocable trusts established by the Museum founder, Archer M. Huntington, which are classified as permanently restricted. The Museum receives distributions on the securities held by the trusts. These distributions are reported in the accompanying statement of activities, net of expenses and are included in income from funds held in trust by others. The Museum paid management fees to JP Morgan Chase Bank of \$235,810 in 2015.

At September 30, 2015, the value recorded for the beneficial interest in trusts is comprised of the following:

JP Morgan Chase Bank Trust #03152009	\$ 42,738,257
JP Morgan Chase Bank Trust #03583005	29,225,013
JP Morgan Chase Bank Trust #98940006	3,393,901
JP Morgan Chase Bank Trust #98843002	2,647,572
JP Morgan Chase Bank Trust #03152306	1,419,162
JP Morgan Chase Bank Trust #03583302	944,266
SunTrust Bank Trust #13214200	1,740,754
Bank of America (formerly U.S. Trust Co. of New York #239550)	741,217
Bank of New York #676580	172,676
Bank of New York #676730	97,818
Bank of New York #676760	76,461
	<u>\$ 83,197,097</u>

The Trustees of the Huntington Trusts (noted above as the trusts being managed by JP Morgan Chase Bank) have adopted a total return policy which distributes 5% of the rolling average market value of the Huntington Trusts, using quarter end value of the preceding twelve quarters ending with September 30 of the current year. The remaining trusts also pay out 5% of the trust assets on an annual basis.

**The Mariners' Museum**  
**Notes to Financial Statements**

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The Museum is also a co-beneficiary with three other not-for-profit organizations under the trust agreement with Bank of America (formerly U.S. Trust Co., of New York). Therefore, the amount recorded in the accompanying statement of financial position is 25% of the trust's value, which represents the Museum's share under this split-interest agreement.

**7. Retirement Plan**

The Museum sponsors a 403(b) Tax Deferred Retirement Plan. The Plan is a defined contribution plan covering substantially all employees. Employees may contribute to the Plan subject to the limitations imposed by the Internal Revenue Service. Effective April 1, 2014, the Museum makes an elective matching contribution of 2% of eligible compensation. The Museum contributed \$53,991 to the Plan during 2015.

**8. Charitable Gift Annuities**

The Museum holds charitable gift annuities, recognized at fair value. Upon the donor's death, the annuity becomes a part of the Museum's endowment fund, and any subsequent distribution earned is available to support Museum operations. The liability to beneficiaries was \$66,715 at September 30, 2015. The discount rates used to calculate the fair value ranged from 4.2% to 7.6% for 2015.

**9. Deferred Revenue**

The Museum's deferred revenue consists primarily of four lease agreements for portions of the Museum's land. In connection with the first agreement, the Museum received an advance rental payment of \$5,000,000, and the lease term extends through 2061. The Museum has deferred the recognition of the amount received, and is amortizing the revenue on a straight-line basis over the lease term at an annual amount of \$69,204. The amount deferred is \$3,200,691 at September 30, 2015.

The second lease agreement is a lease purchase agreement and provides for 20 annual installment payments of \$270,811. The lessee has the option to purchase the land anytime during the lease term, which expires July 5, 2017, and the land conveys upon receipt of the final payment. The payments include principal and interest at 6% and the Museum recognized lease income of \$41,560 in 2015. The Museum deferred the principal payments, which will be recognized at the end of the lease term when the sale is complete. The deferred amount is \$2,582,653 at September 30, 2015.

The third lease agreement commenced on December 1, 2010, and was for an initial term of 20 years. The rent for the initial term was \$65,000, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 and 30 years, respectively, by making payments upon exercise of those options in the amount of \$25,000 and \$20,000, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$3,250 annually over the first 20 years, through 2030, \$1,250 annually for the next 20 years, 2030 - 2050, and \$667 annually for the final 30 years, 2050 - 2080. The deferred amount is \$94,292 at September 30, 2015.

**The Mariners' Museum**  
**Notes to Financial Statements**

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During 2012, the Museum entered into a fourth lease agreement, similar to the above. The lease commenced on May 1, 2012, and was for an initial term of 18.5 years. The rent for the initial term was \$143,780, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 and 30 years, respectively, by making payments upon exercise of those options in the amount of \$65,492 and \$42,650, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$7,772 annually over the first 18.5 years, through 2030, \$3,275 annually for the next 20 years, 2030 - 2050, and \$1,422 annually for the final 30 years, 2050 - 2080. The deferred amount is \$225,368 at September 30, 2015. Additionally, the Museum had various deferred amounts of \$97,790 at September 30, 2015.

**10. Bond Payable**

On October 1, 2005, the Museum entered into an agreement with the Industrial Development Authority of Mathews County, Virginia under which it issued a \$10,000,000 fixed rate bank qualified tax-exempt bond, which was unsecured. The Museum has used the proceeds from the bond to finance the 65,000 square foot expansion of the Museum called the USS Monitor Center.

On February 1, 2012, the Museum refinanced the bond arrangement. Under the new agreement with the Economic Development Authority of Lancaster County, Virginia, the Museum was issued a \$9,600,000 fixed rate bank qualified tax-exempt bond, which is unsecured. This new bond issue retired the existing debt. The bond bears interest at a fixed rate of 2.7% and accrued interest on the unpaid principal balance is due monthly through April 1, 2027. On April 1, 2018, the Museum will begin annual principal payments of \$960,000 through April 1, 2027, when the bond is due and payable in full. Interest expense related to these bonds was \$262,800 for 2015, and is included in general administration on the statement of activities.

Future minimum principal payments are as follows:

2016	\$	-
2017		-
2018		960,000
2019		960,000
2020		960,000
Thereafter		6,720,000
		<u>6,720,000</u>
	\$	<u>9,600,000</u>

**11. Net Asset Restrictions**

Temporarily restricted net assets are available for the following purposes:

Program restrictions, including gallery and exhibit funds, artifacts and collection	<u>\$ 2,661,365</u>
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Permanently restricted net assets are invested to:

Beneficial interest in trusts, a portion of the spending rate which is available to support operations	\$ 83,197,097
Endowment funds	<u>324,171</u>
	<u>\$ 83,521,268</u>

During 2015, \$698,413 of temporarily restricted net assets were released from restrictions and used to fund various gallery upgrades that satisfied donor restrictions and \$259,492 of permanently restricted net assets were reclassified to unrestricted for charitable gift annuities in excess of remaining charitable gift annuity liability.

At September 30, 2015, approximately \$9 million of unrestricted net assets are Board-designated unrestricted net assets, most of which are designated for gallery upgrades.

## **12. Fair Value Measurements**

Accounting standards established a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Museum 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 assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2015.

*Mutual funds:* Valued at the closing price reported on the active market on which the mutual funds are traded.

*Equity securities:* Valued at the closing price reported on the active market on which the equity securities are traded.

*Pledges receivable:* Pledges receivable are reported at net realizable value if at the time the promise is made payment is expected to be received in one year or less. Pledges receivable that are expected to be collected in more than one year are reported at fair value initially and, in subsequent periods, fair value is calculated as the present value of the expected future pledges to be received using a discount rate.

*Beneficial interest in trusts:* Valued using the fair value of the underlying assets of the trust as an estimate for the present value of the expected future cash flows.

**The Mariners' Museum**  
**Notes to Financial Statements**

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Museum believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following sets forth by level, within the fair value hierarchy, the Museum's assets at fair value:

<b>Assets at Fair Value as of September 30, 2015</b>				
	Level 1	Level 2	Level 3	Total
Trading securities:				
Cash and cash equivalents held in investment accounts	\$ 19,904,211	\$ -	\$ -	\$ 19,904,211
Equity securities - US Large Cap	727,946	-	-	727,946
Equity securities - Non US	35,336	-	-	35,336
Mutual funds - equity - other	49,765	-	-	49,765
	<u>20,717,258</u>	<u>-</u>	<u>-</u>	<u>20,717,258</u>
Pledges receivable	-	-	970,956	970,956
Beneficial interest in trusts	-	-	83,197,097	83,197,097
	<u>-</u>	<u>-</u>	<u>83,197,097</u>	<u>83,197,097</u>
<b>Total assets at fair value</b>	<u>\$ 20,717,258</u>	<u>\$ -</u>	<u>\$ 84,168,053</u>	<u>\$ 104,885,311</u>

The table below sets forth a summary of changes in the fair value of the Museum's level 3 investment assets:

	Residential Mortgage- backed Securities	Pledges Receivable	Beneficial Interest in Trusts
<b>Balance - September 30, 2014</b>	\$ 1,442,075	\$ 1,498,472	\$ 89,751,137
Total gains and losses included in change in net assets	(54,429)	-	-
Interest and dividends	47,577	-	-
Withdrawals	(1,435,223)	-	-
New pledges	-	627,700	-
Pledge collections	-	(1,170,264)	-
Pledges written off	-	(10,015)	-
Changes in discount and allowance	-	25,063	-
Adjustment to fair value	-	-	(6,554,040)
	<u>-</u>	<u>-</u>	<u>(6,554,040)</u>
<b>Balance - September 30, 2015</b>	<u>\$ -</u>	<u>\$ 970,956</u>	<u>\$ 83,197,097</u>

### **13. Donor-Designated Endowments**

The Mariners' Museum Endowment (Endowment) was established to support its mission. The Endowment substantially contributes to the growth, financial security and the long-term stability of the Museum.

The Endowment includes two general categories of funds. One category of funds is donor-restricted funds that are restricted for a particular purpose. The second category of funds is composed of receipts from long-term rentals of real estate (primarily described in Note 9) and gifts and bequests to the Museum by donors, which are unrestricted, which the Board of Trustees has designated to function as permanently restricted endowments. With respect to donor-restricted funds, the net assets associated with these endowment funds are classified and reported based on the existence of donor-imposed restrictions. The Board of Trustees of the Museum has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Museum 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) accumulations 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. In accordance with SPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Museum, and (7) the Museum's investment policies.

*Board Designated Endowment.* With respect to those unrestricted funds designated by the Board of Trustees to function as endowments, the operative resolution allows the Board of Trustees to set a spending policy based on such factors as the Board determines appropriate, including, but not limited to, the general economic conditions, the needs of the Museum, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, and other resources available to the Museum.

The principal of the Board Designated Endowment may be expended only with the prior approval of at least two-thirds of the members of the Board of Trustees in office; provided, however, that during any period of five consecutive years, no more than 25% of the principal of the Endowment, measured as of the beginning of that five-year period, may be expended or distributed. The Museum may make loans from the Endowment to the Museum, for its general purpose or for special programs or projects, upon such terms as the Board of Trustees may determine; provided, however, that any loan shall be considered to be a distribution of principal for the purposes of the approval requirement previously stated.

*Investment Return Objectives, Risk Parameters and Strategies.* The Museum has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide a predictable stream of distributions to programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. Accordingly, the investment process seeks to maximize the total return of the Endowment to ensure conservation of the principal while providing appreciable yield, to the extent financially prudent and practicable. Endowment assets are invested in a well-diversified asset mix that is intended to result in a consistent inflation-protected rate of return. Generally, total return shall mean for this purpose that (1) assets are invested to achieve the highest overall return (interest, dividends, and realized as well as unrealized appreciation), consistent with the safety and preservation of the assets and (2) the Board of Trustees, or its designee, may annually determine the amount of the total return that will be treated as distributions available for current use. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

*Spending Policy.* The Museum Board of Trustees governs the use of the Endowment and identifies the mission related programs and services for which the funds will be used.



**The Mariners' Museum**  
**Notes to Financial Statements**

Composition of and changes in endowment net assets at September 30, 2015, are presented below.

Donor-designated endowment net asset composition is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor restricted endowment funds	\$ -	\$ -	\$ 324,171	\$ 324,171

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets - beginning of year	\$ -	\$ -	\$ 595,033	\$ 595,033
Net depreciation	-	-	(11,370)	(11,370)
Reclassification of charitable gift annuities in excess of outstanding liability	-	-	(259,492)	(259,492)
Endowment net assets - end of year	\$ -	\$ -	\$ 324,171	\$ 324,171

**14. Leasing Arrangements**

The Museum leases a 5,400 square foot building to National Oceanic and Atmospheric Administration (NOAA) under a noncancelable lease that expires in February 2025. The lease agreement provides for annual rental payments of \$2,500 per year plus reimbursement of operating expenses incurred by the Museum for the upkeep and maintenance of the building as a shared expense. The operating expenses are estimated by the Museum at the beginning of each year and split into twelve equal installments to be paid by NOAA. Within 120 days after the end of each year the Museum adjusts the rent charged for the actual operating expenses incurred to NOAA and either credits their future rent or requires additional payment, as necessary. The following is a summary of future minimum rental income under the noncancelable operating lease.

Future minimum payments on the above long-term lease are as follows:

2016	\$ 2,500
2017	2,500
2018	2,500
2019	2,500
2020	2,500
Thereafter	10,000
	<u>\$ 22,500</u>

The Museum also has other lease agreements for portions of the Museum's land. The significant agreements are described in Note 9.