

*Financial Statements*  
*Years Ended*  
*December 31, 2012 and 2011*



*The Mariners' Museum*

*Contents*

	<b>Page</b>
<i>Report of Independent Auditors</i>	1
<i>Financial Statements</i>	
<i>Statements of Financial Position</i>	2
<i>Statements of Activities</i>	3 - 4
<i>Statements of Cash Flows</i>	5
<i>Notes to Financial Statements</i>	6 - 19



**DIXON HUGHES GOODMAN** LLP  
Certified Public Accountants and Advisors

## *Independent Auditors' Report*

Board of Trustees  
*The Mariners' Museum*

We have audited the accompanying financial statements of *The Mariners' Museum*, which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of activities and cash flows for the years 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 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 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 December 31, 2012 and 2011, 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.

*Dixon Hughes Goodman LLP*

Newport News, Virginia  
May 2, 2013

*The Mariners' Museum*

*Statements of Financial Position*

<b>December 31,</b>	<b>2012</b>	<b>2011</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents		
Unrestricted	\$ 2,762,972	\$ 3,215,556
Restricted (Note 3)	1,508,582	1,505,102
Certificates of deposit	1,385,069	1,359,283
Accounts receivable	12,424	12,992
Current portion of pledges receivable (Note 4)	1,273,920	1,348,693
Inventories	214,717	281,395
Other current assets	63,659	100,946
<b>Total current assets</b>	<b>7,221,343</b>	<b>7,823,967</b>
<b>Property and equipment - net (Note 6)</b>	<b>33,357,246</b>	<b>34,762,708</b>
<b>Other assets</b>		
Investments		
Investments (Note 5)	14,636,058	12,948,853
Beneficial interest in trusts (Note 7)	83,240,976	79,435,463
Pledges receivable - less current portion (Note 4)	1,661,020	2,024,761
<b>Total other assets</b>	<b>99,538,054</b>	<b>94,409,077</b>
	<b>\$ 140,116,643</b>	<b>\$ 136,995,752</b>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 68,558	\$ 154,006
Accrued expenses	373,567	396,094
<b>Total current liabilities</b>	<b>442,125</b>	<b>550,100</b>
<b>Long-term liabilities</b>		
Charitable gift annuities (Note 9)	100,041	114,396
Bond payable (Note 11)	9,600,000	9,513,381
Deferred revenue (Note 10)	5,760,442	5,370,650
<b>Total liabilities</b>	<b>15,902,608</b>	<b>15,548,527</b>
<b>Net assets</b>		
Unrestricted	37,837,404	39,235,001
Temporarily restricted (Note 12)	2,600,644	2,271,421
Permanently restricted (Note 12)	83,775,987	79,940,803
<b>Total net assets</b>	<b>124,214,035</b>	<b>121,447,225</b>
	<b>\$ 140,116,643</b>	<b>\$ 136,995,752</b>

*The accompanying notes are an integral part of these financial statements.*

*The Mariners' Museum*

*Statement of Activities*

<b>Year Ended December 31, 2012</b>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenue, gains and support</b>				
Realized and unrealized gains (losses) on investments - net	\$ 781,487	\$ (22,821)	\$ 3,836,931	\$ 4,595,597
Grants	-	112,887	-	112,887
Contributions	455,016	382,677	100	837,793
Income from funds held in trust by others	3,948,855	-	-	3,948,855
Dividend and interest income - net	385,443	67,393	10,172	463,008
Memberships	138,447	39,823	-	178,270
Museum shop	154,487	-	-	154,487
Admission fees	307,380	-	-	307,380
Miscellaneous	366,037	11,702	-	377,739
Lease	167,513	-	-	167,513
Education program fees	102,304	-	-	102,304
Photography	41,827	-	-	41,827
Facility rental	111,605	-	-	111,605
Chris Craft	36,492	-	-	36,492
Publications	7,034	-	-	7,034
Boat house	6,714	-	-	6,714
Deaccession	2,719	-	-	2,719
Café	68,808	-	-	68,808
Change in valuation of charitable gift annuities	-	-	(12,019)	(12,019)
Net assets released from restrictions	262,438	(262,438)	-	-
<b>Total revenue, gains and support</b>	<b>7,344,606</b>	<b>329,223</b>	<b>3,835,184</b>	<b>11,509,013</b>
<b>Program expenses</b>				
Education	273,184	-	-	273,184
Collection management	153,817	-	-	153,817
Marketing and special events	631,694	-	-	631,694
Curatorial and conservation	631,846	-	-	631,846
Park and Noland Trail	96,164	-	-	96,164
Facilities management	34,150	-	-	34,150
Library and archives	305,584	-	-	305,584
Exhibit design and production	235,893	-	-	235,893
Photography	139,795	-	-	139,795
Admissions	80,246	-	-	80,246
Museum shop	174,633	-	-	174,633
Café	100,315	-	-	100,315
Publications and graphic design	5,893	-	-	5,893
Chris Craft	24,637	-	-	24,637
<b>Total program expenses</b>	<b>2,887,851</b>	<b>-</b>	<b>-</b>	<b>2,887,851</b>
<b>Supporting expenses</b>				
General administration	3,527,974	-	-	3,527,974
Development and membership	383,361	-	-	383,361
Facilities management	1,929,873	-	-	1,929,873
Museum shop	13,144	-	-	13,144
<b>Total supporting expenses</b>	<b>5,854,352</b>	<b>-</b>	<b>-</b>	<b>5,854,352</b>
<b>Total expenses</b>	<b>8,742,203</b>	<b>-</b>	<b>-</b>	<b>8,742,203</b>
<b>Change in net assets</b>	<b>(1,397,597)</b>	<b>329,223</b>	<b>3,835,184</b>	<b>2,766,810</b>
<b>Net assets - beginning of year</b>	<b>39,235,001</b>	<b>2,271,421</b>	<b>79,940,803</b>	<b>121,447,225</b>
<b>Net assets - end of year</b>	<b>\$ 37,837,404</b>	<b>\$ 2,600,644</b>	<b>\$ 83,775,987</b>	<b>\$ 124,214,035</b>

*The accompanying notes are an integral part of these financial statements.*

*The Mariners' Museum*

*Statement of Activities*

<b>Year Ended December 31, 2011</b>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenue, gains and support</b>				
Realized and unrealized losses on investments - net	\$ (109,465)	\$ (1,465)	\$ (5,829,019)	\$ (5,939,949)
Grants	2,300,400	149,651	-	2,450,051
Contributions	350,529	63,550	100	414,179
Income from funds held in trust by others	3,942,297	-	-	3,942,297
Dividend and interest income - net	256,075	62,985	7,015	326,075
Memberships	162,877	21,750	-	184,627
Museum shop	144,025	-	-	144,025
Admission fees	294,729	-	-	294,729
Miscellaneous	204,549	6,467	-	211,016
Insurance Recovery	520,075	-	-	520,075
Lease	178,873	-	-	178,873
Education program fees	115,790	-	-	115,790
Photography	42,350	-	-	42,350
Facility rental	117,649	-	-	117,649
Chris Craft	33,384	-	-	33,384
Publications	9,048	-	-	9,048
Boat house	5,994	-	-	5,994
Deaccession	1,942	-	-	1,942
Café	72,770	-	-	72,770
Change in valuation of charitable gift annuities	-	-	(12,019)	(12,019)
Net assets released from restrictions	621,581	(621,581)	-	-
<b>Total revenue, gains (losses) and support</b>	<b>9,265,472</b>	<b>(318,643)</b>	<b>(5,833,923)</b>	<b>3,112,906</b>
<b>Program expenses</b>				
Education	284,576	-	-	284,576
Collection management	148,500	-	-	148,500
Marketing and special events	630,151	-	-	630,151
Curatorial and conservation	643,141	-	-	643,141
Park and Noland Trail	156,690	-	-	156,690
Facilities management	48,225	-	-	48,225
Library and archives	298,385	-	-	298,385
Exhibit design and production	149,357	-	-	149,357
Photography	141,415	-	-	141,415
Admissions	85,392	-	-	85,392
Museum shop	132,225	-	-	132,225
Café	116,133	-	-	116,133
Publications and graphic design	6,912	-	-	6,912
Chris Craft	29,639	-	-	29,639
<b>Total program expenses</b>	<b>2,870,741</b>	<b>-</b>	<b>-</b>	<b>2,870,741</b>
<b>Supporting expenses</b>				
General administration	3,673,100	-	-	3,673,100
Development and membership	324,199	-	-	324,199
Facilities management	1,935,553	-	-	1,935,553
Museum shop	54,368	-	-	54,368
<b>Total supporting expenses</b>	<b>5,987,220</b>	<b>-</b>	<b>-</b>	<b>5,987,220</b>
<b>Trust receivable reversal (Note 7)</b>	<b>338,337</b>	<b>-</b>	<b>-</b>	<b>338,337</b>
<b>Total expenses</b>	<b>9,196,298</b>	<b>-</b>	<b>-</b>	<b>9,196,298</b>
<b>Change in net assets</b>	<b>69,174</b>	<b>(318,643)</b>	<b>(5,833,923)</b>	<b>(6,083,392)</b>
<b>Net assets - beginning of year</b>	<b>39,165,827</b>	<b>2,590,064</b>	<b>85,774,726</b>	<b>127,530,617</b>
<b>Net assets - end of year</b>	<b>\$ 39,235,001</b>	<b>\$ 2,271,421</b>	<b>\$ 79,940,803</b>	<b>\$ 121,447,225</b>

*The accompanying notes are an integral part of these financial statements.*

# The Mariners' Museum

## Statements of Cash Flows

<b>Years Ended December 31,</b>	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 2,766,810	\$ (6,083,392)
Adjustments to reconcile to net cash from operating activities:		
Depreciation and amortization	1,871,915	1,915,306
Trust income receivable reversal	-	338,337
Change in allowance for uncollectible pledges	(4,907)	(28,316)
Change in inventory allowance	2,314	(1,230)
Unrealized (gains) losses on investments		
Funds held in trust by others	(3,805,513)	5,823,554
Investments	(768,603)	132,974
Realized gains on investments	(21,481)	(16,953)
Change in valuation of charitable gift annuities	12,019	12,019
Change in:		
Accounts receivable	568	16,644
Government grants receivable	-	508,648
Pledges receivable	443,421	(1,724,840)
Inventories	64,364	45,552
Other current assets	37,287	(7,361)
Accounts payable	(85,448)	(22,795)
Accrued expenses	(22,527)	23,626
Deferred revenue	389,792	103,641
<b>Net cash from operating activities</b>	<b>880,011</b>	<b>1,035,414</b>
<b>Cash flows from investing activities</b>		
Property and equipment acquisitions	(466,453)	(333,634)
Sales and maturities of investments	3,114,005	2,026,782
Purchases of investments	(4,011,125)	(2,120,213)
Maturation of certificate of deposit	1,359,283	1,335,886
Purchase of certificate of deposit	(1,385,069)	(1,359,283)
<b>Net cash from investing activities</b>	<b>(1,389,359)</b>	<b>(450,462)</b>
<b>Cash flows from financing activities</b>		
Payments on charitable gift annuities	(26,375)	(26,375)
Proceeds from bond payable	86,619	-
<b>Net cash from financing activities</b>	<b>60,244</b>	<b>(26,375)</b>
<b>Net change in cash and cash equivalents</b>	<b>(449,104)</b>	<b>558,577</b>
<b>Cash and cash equivalents - beginning of year</b>	<b>4,720,658</b>	<b>4,162,081</b>
<b>Cash and cash equivalents - end of year</b>	<b>\$ 4,271,554</b>	<b>\$ 4,720,658</b>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 300,532	\$ 388,380
<b>Supplemental disclosure of noncash information</b>		
Construction in progress transferred to property and equipment for assets placed in service	\$ 279,400	\$ 335,573

The accompanying notes are an integral part of these financial statements.

# *The Mariners' Museum*

## *Notes to Financial Statements*

---

December 31, 2012 and 2011

---

### 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. On December 6, 2011, the Board of Trustees of *The Mariners' Museum* adopted a new strategic plan. This plan restated the mission statement. *The Mariners' Museum* makes a difference in people's lives, inviting them to discover their relationship to the sea by exploring maritime culture, science and technology. *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 plan lays out four key strategic objectives as well as metrics by which *The Mariners' Museum* will measure success.

### 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 account 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. Included in cash and cash equivalents balances are amounts restricted, primarily for future property and equipment acquisitions.

## **Certificates of Deposit**

Excess cash is invested in certificates of deposit, which mature at various times and earn interest at various rates. Certificates of deposit are stated at cost plus accrued interest earned.

## **Inventories**

Inventories consist of gift shop items, Museum and café inventory, 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 \$170,589 and \$229,813 at December 31, 2012 and 2011, respectively, publications inventory was \$49,031 and \$50,483 at December 31, 2012 and 2011, respectively, and café inventory was \$-0- and \$3,688 at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, a valuation allowance of \$4,903 and \$2,589, respectively, 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 statements 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 13 for discussion of fair value measurements. Investments in mortgage backed securities are valued at their fair value as determined by the investment company from prices obtained from independent quotation bureaus that use computerized valuation formulas to calculate current value. Investment distribution or loss (including gains and losses on investments, interest and dividends) is included in the statements 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 statements 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 statements 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
The Noland Trail	20
Land improvements	10 - 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 statements of activities and the cost and related accumulated depreciation, if applicable, are removed from the accounts. For capital assets purchased with restricted cash or 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 statements of financial position. Only current year purchases and proceeds from sale are reflected in the statements 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. 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 Museum received in-kind contributions of \$16,634 and \$9,458 in 2012 and 2011, respectively. These contributions were primarily related to advertising and artifacts. Additionally, the Museum received volunteer hours of 17,334 and 18,924 in 2012 and 2011, respectively. No amounts have been recognized in the statements 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 statements of activities when the restriction has been satisfied.

## **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 \$140,358 and \$127,321 for 2012 and 2011, respectively, excluding donated advertising.

## 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). The Museum has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2012 and 2011. Fiscal years ending on or after December 31, 2009, remain subject to examination by federal and state tax authorities.

## Credit Risk

Financial instruments that potentially expose the Museum to concentrations of credit risk consist primarily of cash and cash equivalents, certificates of deposit, and investments. Cash and cash equivalents, certificates of deposit and investments are maintained at high quality financial institutions and exposure is limited to any one institution. During 2009, the Museum entered into a sweep to master note agreement where cash and cash equivalents in this account are invested in master note obligations that mature daily. Master note obligations are not bank deposits and; therefore, are not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2012 and 2011, \$3,947,578 and \$4,094,753, respectively, of cash and cash equivalents were held in the sweep account. All other accounts at financial institutions are insured by the FDIC up to the legal limit. The Museum has not experienced any losses on its cash equivalents.

## Subsequent Events

In preparing these financial statements, the Museum has evaluated events and transactions for potential recognition or disclosure through May 2, 2013, the date the financial statements were available to be issued.

### 3. Restricted Cash

The Museum's restricted cash is held for the following restriction:

	<u>2012</u>	<u>2011</u>
Maritime Galleries and Exhibit Funding	\$ 1,508,582	\$ 1,505,102

### 4. Pledges Receivable

The Museum records pledges receivable as income in the year the promise is received. In 2011, the Museum recorded the second 5 years of the City of Newport News' 10-year *Monitor* Center pledge at \$2,300,000. Pledges receivable have the following restrictions:

	<u>2012</u>	<u>2011</u>
The Monitor Center campaign	\$ 2,720,989	\$ 3,351,238
General operating and library support	212,951	21,216
Other temporarily restricted contributions	1,000	1,000
	<u>\$ 2,934,940</u>	<u>\$ 3,373,454</u>

The anticipated cash flows from pledges receivable is as follows:

	<b>2012</b>	<b>2011</b>
Receivable in less than one year	\$ 1,273,920	\$ 1,348,693
Receivable in one to five years	1,766,191	2,183,960
Total pledges receivable	<u>3,040,111</u>	<u>3,532,653</u>
Less - discounts to net realizable value	(44,806)	(93,927)
Less - allowance for uncollectible pledges	(60,365)	(65,272)
	<u>2,934,940</u>	<u>3,373,454</u>
Less - current portion	(1,273,920)	(1,348,693)
	<u>\$ 1,661,020</u>	<u>\$ 2,024,761</u>

At December 31, 2012 and 2011, the discount rates used ranged from 0.25% to 4.9%.

## 5. Investments

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

	<b>2012</b>	<b>2011</b>
Equity securities	\$ 5,771,508	\$ 5,273,776
Bonds	6,232,690	5,157,438
Real estate securities	544,907	452,017
Money funds	687,735	579,260
Mortgage-backed securities	1,399,218	1,486,362
	<u>\$ 14,636,058</u>	<u>\$ 12,948,853</u>

The investments are under the management of Frank Russell Investment Company, UBS Commercial Services, Inc., and Wells Fargo Advisors, LLC, who also maintain custody of the securities. The Museum's investments are in mutual funds and investment income is reported in the accompanying statements of activities, net of investment management fees.

Fair values and unrealized gains (losses) are summarized as follows:

<b><u>December 31, 2012</u></b>	Cost	Fair Value	Unrealized Gain (Loss)
Frank Russell Investment Company	\$ 12,482,327	\$ 13,083,461	\$ 601,134
Wells Fargo Advisors, LLC	41,068	44,016	2,948
UBS Commercial Services, Inc.	1,498,477	1,508,581	10,104
	<u>\$ 14,021,872</u>	<u>\$ 14,636,058</u>	<u>\$ 614,186</u>
<b><u>December 31, 2011</u></b>			
Frank Russell Investment Company	\$ 11,616,971	\$ 11,404,262	\$ (212,709)
Wells Fargo Advisors, LLC	36,608	39,489	2,881
UBS Commercial Services, Inc.	1,496,487	1,505,102	8,615
	<u>\$ 13,150,066</u>	<u>\$ 12,948,853</u>	<u>\$ (201,213)</u>

## 6. Property and Equipment

Property and equipment consist of the following:

	<b>2012</b>	<b>2011</b>
Building and improvements	\$ 50,585,292	\$ 50,405,345
Furniture and equipment	6,183,502	5,990,304
The Noland Trail	2,219,802	2,219,802
Land improvements	4,656,952	4,572,952
Lakes, dams and improvements	626,901	626,901
	<hr/> 64,272,449	<hr/> 63,815,304
Less - accumulated depreciation	(30,925,512)	(29,053,597)
	<hr/> 33,346,937	<hr/> 34,761,707
Construction in process	10,309	1,001
	<hr/> \$ 33,357,246	<hr/> \$ 34,762,708

Depreciation expense for 2012 and 2011 was \$1,871,917 and \$1,915,306, respectively.

## 7. Beneficial Interest in Trusts

The Museum is the beneficiary of various irrevocable trusts established by the Museum founder, Archer M. Huntington, that are classified as permanently restricted. The Museum receives distributions on the securities held by the trusts. These distributions are reported in the accompanying statements of activities, net of expenses. The Museum paid management fees to JP Morgan Chase Bank of \$203,533 and \$137,155 in 2012 and 2011, respectively.

The value recorded for the beneficial interest in trusts is comprised of the following:

	<b>2012</b>	<b>2011</b>
JP Morgan Chase Bank Trust #3152009	\$ 47,534,610	\$ 45,288,565
JP Morgan Chase Bank Trust #3583005	32,815,822	31,415,459
SunTrust Bank Trust #13214200	1,747,292	1,636,060
Bank of America (formerly U.S. Trust Co. of New York #239550)	755,833	698,859
Bank of New York #676580	193,831	200,240
Bank of New York #676730	109,406	110,719
Bank of New York #676760	84,182	85,561
	<hr/> \$ 83,240,976	<hr/> \$ 79,435,463

The Museum has adopted a total return policy with respect to distributions received from its Huntington Trust at JP Morgan. This total return policy allows the Museum to receive distributions based upon 4.5% of the rolling average market value of the trusts, using the quarter end value for the preceding twelve quarters, ending with September 30 of the current year. For 2012 and 2011, the Board of Trustees approved a temporary increase to the total return policy which allowed the Museum to receive distributions based upon 5.0% of the preceding twelve quarters rolling average of the fair market value of the trusts. The remaining trusts also pay out 5.0% of the trust assets on an annual basis.

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 statements of financial position is 25% of the trust's value, which represents the Museum's share under this split-interest agreement.

In 2012, the Museum and JP Morgan Chase Bank Trusts adopted a new method for calculating the distribution from the trust. Historically, the income distribution was calculated in January of the year it was for, so the January payment that the Museum would receive from JP Morgan would be the twelfth payment from the preceding year. In 2011, the Museum and JP Morgan agreed to use the same method, still based on a rolling average, but the years used for calculation end on September 30<sup>th</sup> of the preceding year. During 2012, the Museum and JP Morgan also agreed that instead of using the prior three year rolling average, that the rolling average of the prior twelve quarters would be used. This is intended to give the Museum a more level income stream of distribution.

## **8. Retirement Plan**

The Museum has 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 March 1, 2009, the Museum no longer makes contributions to the Plan.

## **9. Charitable Gift Annuities**

The Museum holds charitable gift annuities, recognized at fair value, which earn income that is permanently restricted and added to the annuity until the donor's death. 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 \$100,041 and \$114,396, at December 31, 2012 and 2011, respectively. The discount rates used to calculate the fair value ranged from 4.20% to 7.60% for both 2012 and 2011.

## **10. 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 \$3,391,002 and \$3,460,206 at December 31, 2012 and 2011, respectively.

The second lease agreement 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. The payments include principal and interest at 6% and the Museum recognized lease income of \$76,415 and \$87,708 in 2012 and 2011, respectively. The Museum deferred the principal payments, which will be recognized at the end of the lease term. These deferred amounts are \$1,982,680 and \$1,788,284 at December 31, 2012 and 2011, respectively.

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 amounts are \$103,229 and \$106,479 at December 31, 2012 and 2011, respectively.

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 amounts are \$246,741 and \$-0- at December 31, 2012 and 2011, respectively. Additionally, the Museum had various deferred amounts of \$36,790 and \$15,681 at December 31, 2012 and 2011, respectively.

## 11. 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 is unsecured. The bond provided for a maximum borrowing of \$10,000,000, bore interest at a fixed rate of 4.03% and interest only was payable monthly beginning January 1, 2006, through November 1, 2015, at which time the entire outstanding principal balance was to be due along with any accrued interest.

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 \$288,703 and \$388,714 for 2012 and 2011, respectively.

## 12. Net Asset Restrictions

Temporarily restricted net assets are available for the following purposes:

	<u>2012</u>	<u>2011</u>
Program restrictions	\$ 2,600,644	\$ 2,271,421

Permanently restricted net assets are invested to:

	<u>2012</u>	<u>2011</u>
Beneficial interest in trusts, a portion of the spending rate which is available to support operations	\$ 83,240,976	\$ 79,435,463
Endowment funds	535,011	505,340
	<u>\$ 83,775,987</u>	<u>\$ 79,940,803</u>

### 13. 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 December 31, 2012 and 2011.

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

*Money funds:* Short-term securities purchased within 60 days to maturity are valued at amortized cost, which approximates market value.

*Mortgage-backed securities:* Prices of asset backed securities are obtained from independent quotation bureaus that use computerized valuation formulas to calculate current values.

*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 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 December 31, 2012</b>			
	Level 1	Level 2	Level 3	Total
<b>Trading securities:</b>				
Mutual funds - bonds / fixed income	\$ 6,232,689	\$ -	\$ -	\$ 6,232,689
Mutual funds - international	1,045,127	-	-	1,045,127
Mutual funds - real estate	544,907	-	-	544,907
Mutual funds - equity - other	4,726,382	-	-	4,726,382
Money funds	687,734	-	-	687,734
<b>Fixed income:</b>				
Residential mortgage-backed securities	-	-	1,399,219	1,399,219
	13,236,839	-	1,399,219	14,636,058
Pledges receivable	-	-	2,934,940	2,934,940
Beneficial interest in trusts	-	-	83,240,976	83,240,976
<b>Total assets at fair value</b>	<b>\$ 13,236,839</b>	<b>\$ -</b>	<b>\$ 87,575,135</b>	<b>\$ 100,811,974</b>

**Assets at Fair Value as of December 31, 2011**

	Level 1	Level 2	Level 3	Total
Trading securities:				
Mutual funds - bonds/fixed income	\$ 5,157,438	\$ -	\$ -	\$ 5,157,438
Mutual funds - international	891,632	-	-	891,632
Mutual funds - real estate	452,017	-	-	452,017
Mutual funds - equity - other	4,382,144	-	-	4,382,144
Money funds	579,260	-	-	579,260
Fixed income:				
Residential mortgage-backed securities	-	-	1,486,362	1,486,362
	11,462,491	-	1,486,362	12,948,853
Pledges receivable	-	-	3,373,454	3,373,454
Beneficial interest in trusts	-	-	79,435,463	79,435,463
Total assets at fair value	\$ 11,462,491	\$ -	\$ 84,295,279	\$ 95,757,770

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 - December 31, 2011</b>	\$ 1,486,362	\$ 3,373,454	\$ 79,435,463
Total gains and losses included in change in net assets	(50,233)	-	-
Investment sales	(1,226,578)	-	-
Investment purchases	1,189,668	-	-
New pledges	-	349,665	-
Pledge collections	-	(770,960)	-
Pledges written off	-	(60,554)	-
Adjustment to fair value	-	43,335	3,805,513
<b>Balance - December 31, 2012</b>	\$ 1,399,219	\$ 2,934,940	\$ 83,240,976

**14. Donor-Designated Endowments (UPMIFA State) After Implementation of FSP FAS 117-1**

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 10) 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 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.

Composition of and changes in endowment net assets at December 31, 2012, are presented below.

Endowment net asset composition and type of fund is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor restricted endowment funds	\$ -	\$ -	\$ 535,011	\$ 535,011

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets - beginning of year	\$ -	\$ -	\$ 505,340	\$ 505,340
Contributions	-	-	100	100
Investment income	-	-	10,172	10,172
Net appreciation	-	-	19,399	19,399
Endowment net assets - end of year	\$ -	\$ -	\$ 535,011	\$ 535,011

Composition of and changes in endowment net assets at December 31, 2011, are presented below.

Endowment net asset composition and type of fund is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor restricted endowment funds	\$ -	\$ -	\$ 505,340	\$ 505,340

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets - beginning of year	\$ -	\$ -	\$ 515,710	\$ 515,710
Contributions	-	-	100	100
Investment income	-	-	7,015	7,015
Net depreciation	-	-	(17,485)	(17,485)
Endowment net assets - end of year	\$ -	\$ -	\$ 505,340	\$ 505,340

## 15. 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:

2013	\$	2,500
2014		2,500
2015		2,500
2016		2,500
2017		2,500
Thereafter		<u>17,500</u>
	\$	<u>30,000</u>

The Museum also has other lease agreements for portions of the Museum's land. The significant agreements are described in Note 10.

## 16. Commitment

The Museum entered into an agreement with Christopher Newport University (CNU) whereby CNU agreed to update its library to house a portion of the Museum's library collection. Under the terms of this agreement, the Museum agreed to reimburse CNU for a portion of the interest expense incurred to fund the library renovations. During 2012 and 2011, the Museum paid CNU \$-0- and \$15,181, respectively, which was capitalized in building and improvements. During 2009, the Museum also agreed to begin reimbursing CNU each month for a portion of the CNU Library Director's salary and benefits. Total reimbursements were \$39,360 and \$38,952 for 2012 and 2011, respectively.

\* \* \* \* \*