Financial Statements
Years Ended
December 31, 2011 and 2010

The Mariners' Museum

The Mariners' Museum

DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

The Mariners' Museum

Contents

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Report of Independent Auditors

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We have audited the accompanying statement of financial position of ***The Mariners' Museum*** as of December 31, 2011, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of ***The Mariners' Museum's*** management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of December 31, 2010, were audited by Goodman & Company, LLP, who merged into Dixon Hughes Goodman LLP as of April 1, 2011, and whose report dated March 22, 2011, expressed an unqualified opinion on those statements.

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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2011 financial statements referred to above present fairly, in all material respects, the financial position of ***The Mariners' Museum*** as of December 31, 2011, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Dixon Hughes Goodman LLP

Newport News, Virginia
June 8, 2012

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The Mariners' Museum

Statements of Financial Position

December 31,	2011	2010
Assets		
Current assets		
Cash and cash equivalents		
Unrestricted	$ 3,215,556	$ 2,715,424
Restricted (footnote 3)	1,505,102	1,446,657
Certificate of deposit	1,359,283	1,335,886
Accounts receivable	12,992	29,636
Trust income receivable (footnote 8)	-	338,337
Current portion of government grants receivable (footnote 4)	-	508,648
Current portion of pledges receivable (footnote 5)	1,348,693	1,521,181
Inventories	281,395	325,717
Other current assets	100,946	93,585
Total current assets	7,823,967	8,315,071
Property and equipment - net (footnote 7)	34,762,708	36,344,392
Other assets		
Investments		
Investments (footnote 6)	12,948,853	12,971,432
Beneficial interest in trusts (footnote 8)	79,435,463	85,259,016
Pledges receivable - less current portion (footnote 5)	2,024,761	99,117
Total other assets	94,409,077	98,329,565
	$ 136,995,752	$ 142,989,028
Liabilities and Net Assets		
Current liabilities		
Accounts payable	$ 154,006	$ 176,801
Accrued expenses	396,094	372,468
Total current liabilities	550,100	549,269
Long-term liabilities		
Charitable gift annuities (footnote 10)	114,396	128,752
Bond payable (footnote 12)	9,513,381	9,513,381
Deferred revenue (footnote 11)	5,370,650	5,267,009
Total liabilities	15,548,527	15,458,411
Net assets		
Unrestricted	39,235,001	39,165,827
Temporarily restricted (footnote 13)	2,271,421	2,590,064
Permanently restricted (footnote 13)	79,940,803	85,774,726
Total net assets	121,447,225	127,530,617
	$ 136,995,752	$ 142,989,028

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

The Mariners' Museum

Statement of Activities

Year Ended December 31, 2011	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, gains and support				
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 restriction	621,581	(621,581)	-	-
Total revenue, gains and support	9,265,472	(318,643)	(5,833,923)	3,112,906
Program expenses				
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
Total program expenses	2,870,741	-	-	2,870,741
Supporting expenses				
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
Total supporting expenses	5,987,220	-	-	5,987,220
Trust receivable reversal (Footnote 8)	338,337	-	-	338,337
Total expenses	9,196,298	-	-	9,196,298
Change in net assets	69,174	(318,643)	(5,833,923)	(6,083,392)
Net assets - beginning of year	39,165,827	2,590,064	85,774,726	127,530,617
Net assets - end of year	$ 39,235,001	$ 2,271,421	$ 79,940,803	$ 121,447,225

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

The Mariners' Museum

Statement of Activities

Year Ended December 31, 2010	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, gains and support				
Realized and unrealized gains on investments - net	$ 716,261	$ 47,134	$ 4,726,094	$ 5,489,489
Grants	-	414,069	-	414,069
Contributions	410,057	95,129	800	505,986
Income from funds held in trust by others	4,120,248	-	-	4,120,248
Dividend and interest income - net	296,187	69,803	9,291	375,281
Memberships	159,694	24,450	-	184,144
Museum shop	112,092	-	-	112,092
Admission fees	292,959	-	-	292,959
Miscellaneous	175,598	9,781	-	185,379
Lease	196,058	-	-	196,058
Education program fees	92,878	-	-	92,878
Photography	52,528	-	-	52,528
Facility rental	107,430	-	-	107,430
Chris Craft	36,445	-	-	36,445
Publications	9,269	-	-	9,269
Boat house	6,430	-	-	6,430
Café	64,884	-	-	64,884
Change in valuation of charitable gift annuities	-	-	(12,019)	(12,019)
Net assets released from restriction	528,454	(528,454)	-	-
Total revenue, gains (losses) and support	7,377,472	131,912	4,724,166	12,233,550
Program expenses				
Education	248,407	-	-	248,407
Collection management	146,922	-	-	146,922
Marketing and special events	448,281	-	-	448,281
Curatorial and conservation	686,761	-	-	686,761
Park and Noland Trail	154,121	-	-	154,121
Facilities management	38,296	-	-	38,296
Library and archives	313,768	-	-	313,768
Exhibit design and production	179,959	-	-	179,959
Photography	120,445	-	-	120,445
Admissions	91,153	-	-	91,153
Museum shop	107,011	-	-	107,011
Café	108,924	-	-	108,924
Publications and graphic design	5,147	-	-	5,147
Chris Craft	34,080	-	-	34,080
Total program expenses	2,683,275	-	-	2,683,275
Supporting expenses				
General administration	3,515,372	-	-	3,515,372
Development and membership	336,585	-	-	336,585
Facilities management	1,952,024	-	-	1,952,024
Museum shop	15,890	-	-	15,890
Total supporting expenses	5,819,871	-	-	5,819,871
Total expenses	8,503,146	-	-	8,503,146
Change in net assets	(1,125,674)	131,912	4,724,166	3,730,404
Net assets - beginning of year	40,291,501	2,458,152	81,050,560	123,800,213
Net assets - end of year	$ 39,165,827	$ 2,590,064	$ 85,774,726	$ 127,530,617

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

The Mariners' Museum

Statements of Cash Flows

Years Ended December 31,	**2011**	**2010**
Cash flows from operating activities		
Change in net assets	$ (6,083,392)	$ 3,730,404
Adjustments to reconcile to net cash from operating activities:		
Depreciation and amortization	1,915,306	1,944,158
Trust income receivable reversal	338,337	-
Change in allowance for uncollectible pledges	(28,316)	24,213
Change in inventory allowance	(1,230)	(306)
Unrealized gains on investments		
Funds held in trust by others	5,823,554	(4,691,369)
Investments	132,974	(787,217)
Realized gains on investments	(16,953)	(10,903)
Change in valuation of charitable gift annuities	12,019	12,019
Change in:		
Accounts receivable	16,644	(699)
Trust income receivable	-	21,909
Government grants receivable	508,648	739,272
Pledges receivable	(1,724,840)	545,634
Inventories	45,552	(1,058)
Other current assets	(7,361)	(44,543)
Accounts payable	(22,795)	81,431
Accrued expenses	23,626	12,601
Deferred revenue	103,641	214,482
Net cash from operating activities	1,035,414	1,790,028
Cash flows from investing activities		
Property and equipment acquisitions	(333,634)	(496,938)
Sales and maturities of investments	2,026,782	1,973,917
Purchases of investments	(2,120,213)	(3,729,872)
Maturation of certificate of deposit	1,335,886	1,317,793
Purchase of certificate of deposit	(1,359,283)	(1,335,886)
Net cash from investing activities	(450,462)	(2,270,986)
Cash flows from financing activities		
Payments on charitable gift annuities	(26,375)	(26,374)
Net change in cash and cash equivalents	558,577	(507,332)
Cash and cash equivalents - beginning of year	4,162,081	4,669,413
Cash and cash equivalents - end of year	$ 4,720,658	$ 4,162,081
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 388,380	$ 389,733
Supplemental disclosure of noncash information		
Construction in progress transferred to property and equipment for assets placed in service	$ 335,573	$ 526,106

The accompanying notes are an integral part of these 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. 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' 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 expires, 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 restricted to investments in perpetuity, the income from which 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 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 $229,813 and $283,997 at December 31, 2011 and 2010, respectively, publications inventory was $50,483 and $38,186 at December 31, 2011 and 2010, respectively, and café inventory was $3,688 and $7,353 at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, a valuation allowance of $2,589 and $3,819, 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 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 14 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 income 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.

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:

	Years
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.

Collection

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 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.

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 since the funds are invested in perpetuity. The income 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.

The Museum received in-kind contributions of $9,458 and $24,639 in 2011 and 2010, respectively. These contributions were primarily related to advertising and artifacts. Additionally, the Museum received volunteer hours of 18,924 and 19,477 in 2011 and 2010, respectively.

During 2007, the Museum received a conditional pledge of $100,000 to be collected over a five-year period beginning in 2009. During both 2011 and 2010, the donor made $20,000 payments, which is included in contributions on the statement of activities.

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 $127,321 and $102,286 for 2011 and 2010, 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, 2011 and 2010. Fiscal years ending on or after December 31, 2008, 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, 2011 and 2010, $4,094,753 and $4,065,606, 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.

Reclassifications

Certain amounts in the 2010 financial statements have been reclassified to conform to the 2011 financial statement presentation. Such reclassifications do not affect the previously reported net assets.

Subsequent Events

In preparing these financial statements, the Museum has evaluated events and transactions for potential recognition or disclosure through June 8, 2012, the date the financial statements were available to be issued.

During 2011, the Museum was engaged in negotiations to refinance bond debt discussed in Note 12. These negotiations were successfully completed on March 14, 2012. The Museum entered into a new agreement with the Economic Development Authority of Lancaster County, Virginia under which it issued a $9,600,000 fixed rate bank qualified tax-exempt bond, which is unsecured. This new bond issue retired the existing debt. The new bond is at a fixed rate of 2.7% with interest only payments through April 1, 2017. On April 1, 2018 the Museum will begin an annual principal payment of $960,000 through April 1, 2027, when the debt is paid in full.

3. Restricted Cash

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

	2011	2010
Maritime Galleries and Exhibit Funding	$ 1,505,102	$ 1,446,657

4. Government Grants Receivable

The anticipated cash flow from municipal grants and other grants receivable is as follows:

	2011	2010
Receivable in less than one year	$ -	$ 508,648
Receivable in one to five years	-	-
Total government grants receivable	-	508,648
Less - current portion	-	(508,648)
	$ -	$ -

5. 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:

	2011	2010
The Monitor Center campaign	$ 3,351,238	$ 1,598,020
Virginia Commission for the Arts & Foundation for Humanities	-	2,900
General operating and library support	21,216	18,378
Other temporarily restricted contributions	1,000	1,000
	$ 3,373,454	$ 1,620,298

The anticipated cash flows from pledges receivable is as follows:

	2011	2010
Receivable in less than one year	$ 1,348,693	$ 1,521,181
Receivable in one to five years	2,183,960	278,112
Total pledges receivable	3,532,653	1,799,293
Less - discounts to net realizable value	(93,927)	(85,407)
Less - allowance for uncollectible pledges	(65,272)	(93,588)
	3,373,454	1,620,298
Less - current portion	(1,348,693)	(1,521,181)
	$ 2,024,761	$ 99,117

At December 31, 2011 and 2010, the discount rates used ranged from 0.25% to 4.9%.

6. Investments

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

	2011	2010
Equity securities	$ 5,273,776	$ 5,505,045
Bonds	5,157,438	4,984,025
Real estate securities	452,017	486,470
Money funds	579,260	580,930
Mortgage-backed securities	1,486,362	1,414,962
	$ 12,948,853	$ 12,971,432

The investments are under the management of Frank Russell Investment Company, UBS Commercial Services, Inc., and Wells Fargo Advisors, LLC (formerly Wachovia Securities, Inc.), 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:

December 31, 2011	Cost	Fair Value	Unrealized Gain (Loss)
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
	$ 13,150,066	$ 12,948,853	$ (201,213)
December 31, 2010			
Frank Russell Investment Company	$ 11,560,487	$ 11,487,355	$ (73,132)
Wells Fargo Advisors, LLC	36,896	37,420	524
UBS Commercial Services, Inc.	1,437,966	1,446,657	8,691
	$ 13,035,349	$ 12,971,432	$ (63,917)

7. Property and Equipment

Property and equipment consist of the following:

	2011	2010
Building and improvements	$ 50,405,345	$ 50,174,197
Furniture and equipment	5,990,304	5,889,817
The Noland Trail	2,219,802	2,215,864
Land improvements	4,572,952	4,572,952
Lakes, dams and improvements	626,901	626,901
	63,815,304	63,479,731
Less - accumulated depreciation	(29,053,597)	(27,138,291)
	34,761,707	36,341,440
Construction in process	1,001	2,952
	$ 34,762,708	$ 36,344,392

8. Beneficial Interest in Trusts

The Museum is the beneficiary of various irrevocable trusts established by the Museum founder, Archer M. Huntington, who has directed that the assets of the trusts be invested in perpetuity and that the related income be paid to the Museum. 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 $137,155 and $326,586 in 2011 and 2010, respectively. The 2010 management fee was a catch-up fee covering the years back to 2006.

Realized and unrealized gains and losses, as well as all other earnings on the market value of the funds held in trust are recorded as permanently restricted gains and losses.

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

	2011	2010
JP Morgan Chase Bank Trust #3152009	$ 45,288,565	$ 48,662,961
JP Morgan Chase Bank Trust #3583005	31,415,459	33,749,128
SunTrust Bank Trust #13214200	1,636,060	1,730,677
Bank of America (formerly U.S. Trust Co. of New York #239550)	698,859	730,270
Bank of New York #676580	200,240	201,096
Bank of New York #676730	110,719	104,603
Bank of New York #676760	85,561	80,281
	$ 79,435,463	$ 85,259,016

As of January 1, 2002, the Museum adopted a total return policy with respect to income received from its JP Morgan Chase Bank Trusts. This total return policy allows the Museum to receive income based upon 4.5% of the most recent three-year rolling average of the fair market value of the trusts. Therefore, the income distribution may consist of dividends, interest and proceeds from securities sales. For 2011 and 2010, the Board of Trustees approved a temporary increase to the total return policy which allowed the Museum to receive income based upon 5.0% of the most recent three-year rolling average of the fair market value of the trusts. The remaining trusts distribute income based on dividends and interest only.

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 2011, the Museum and JP Morgan Chase Bank Trusts adopted a new method for calculating the income 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 30th of the preceding year. The Museum has historically recorded the twelfth payment received in January of the following year as trust receivable. Due to the change in calculation period in 2011, the Museum had to reverse the trust receivable that was rolling forward; the trust receivable reversal of $338,337, and is shown as other expense on the statement of activities for 2011.

9. Retirement Plan

The Museum has a 403(b) Tax Deferred Retirement Plan; the Plan is fully funded. 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.

10. 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 income earned is available to support Museum operations. The liability to beneficiaries was $114,396 and $128,752, at December 31, 2011 and 2010, respectively. The discount rates used to calculate the fair value ranged from 4.20% to 7.60% for both 2011 and 2010.

11. Deferred Revenue

The Museum's deferred revenue consists primarily of three 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 $3,460,206 and $3,529,410 at December 31, 2011 and 2010, 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 $87,708 and $98,346 in 2011 and 2010, respectively. The Museum deferred the principal payments, which will be recognized at the end of the lease term. These deferred amounts are $1,788,284 and $1,605,181 a t December 31, 2011 and 2010, 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 $106,479 and $109,729 at December 31, 2011 and 2010, respectively. Additionally, the Museum had various deferred amounts of $15,681 and $22,689 at December 31, 2011 and 2010, respectively.

12. 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 provides for a maximum borrowing of $10,000,000, bears interest at a fixed rate of 4.03% and interest only is payable monthly beginning January 1, 2006, through November 1, 2015, at which time the entire outstanding principal balance is due along with any accrued interest. Interest expense for 2011 and 2010 was $388,714.

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.

Subsequent to year-end, the Museum completed the refinancing of this bond. See Note 2 for additional information regarding the subsequent event.

13. Net Asset Restrictions

Temporarily restricted net assets are available for the following purposes:

	2011	2010
Program restrictions	$ 2,271,421	$ 2,590,064

Permanently restricted net assets are invested in perpetuity to:

	2011	2010
Beneficial interest in trusts, a portion of the spending rate which is available to support operations	$ 79,435,463	$ 85,259,016
Endowment funds, the income from which is permanently restricted	505,340	515,710
	$ 79,940,803	$ 85,774,726

14. 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, 2011 and 2010.

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 perpetual 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:

	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

	Assets at Fair Value as of December 31, 2010			
	Level 1	Level 2	Level 3	Total
Trading securities:				
Mutual funds - bonds/fixed income	$ 4,984,025	$ -	$ -	$ 4,984,025
Mutual funds - international	972,922	-	-	972,922
Mutual funds - real estate	486,470	-	-	486,470
Mutual funds - equity - other	4,532,123	-	-	4,532,123
Money funds	580,930	-	-	580,930
Fixed income:				
Residential mortgage-backed securities	-	-	1,414,962	1,414,962
	11,556,470	-	1,414,962	12,971,432
Pledges receivable	-	-	1,620,298	1,620,298
Beneficial interest in trusts	-	-	85,259,016	85,259,016
Total assets at fair value	$ 11,556,470	$ -	$ 88,294,276	$ 99,850,746

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
Balance - December 31, 2010	$ 1,414,962	$ 1,620,298	$ 85,259,016
Total gains and losses included in change in net assets	3,399	-	-
Investment sales	(1,166,536)	-	-
Investment purchases	1,234,537	-	-
New pledges	-	2,317,606	-
Pledge collections	-	(533,468)	-
Pledges written off	-	(50,778)	-
Adjustment to fair value	-	19,796	(5,823,553)
Balance - December 31, 2011	$ 1,486,362	$ 3,373,454	$ 79,435,463

15. 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 11) and gifts and bequests to the Museum by donors, which are unrestricted, which the Board of Trustees has designated to function as a 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.

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.

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 funding 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; (2) the Board of Trustees, or its designee, may annually determine the amount of the total return that will be treated as income available for current use; and (3) appreciation, in addition to interest and dividends, may comprise the sum treated as income available for current use in accordance with the spending policy. 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.

Except as otherwise authorized or directed under the terms of any gift, principal of the 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. The Board of Trustees may also adopt a policy by majority vote allowing for as much as 10% of the unrealized appreciation on an annual basis to be treated as income.

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

Composition of and changes in endowment net assets at December 31, 2010, 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	$ -	$ -	$ 515,710	$ 515,710

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets - beginning of year	$ -	$ -	$ 482,913	$ 482,913
Contributions	-	-	800	800
Investment income	-	-	9,292	9,292
Net appreciation	-	-	22,705	22,705
Endowment net assets - end of year	$ -	$ -	$ 515,710	$ 515,710

16. 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. 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:

2012	$	2,500
2013		2,500
2014		2,500
2015		2,500
2016		2,500
Thereafter		20,000
	$	32,500

The Museum also has other lease agreements for portions of the Museum's land. The significant agreements are described in Note 11.

17. Commitment

The Museum entered into an agreement with Christopher Newport University (CNU) whereby CNU agreed to update a portion of its library to house 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 2011 and 2010, the Museum paid CNU $15,181 and $43,012, 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 $38,952 and $38,760 for 2011 and 2010, respectively.

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