



# The Mariners' Museum

Financial Statements as of and for the Nine Month  
Period Ended September 30, 2014

# ***The Mariners' Museum***

## **Contents**

	<b>Page</b>
<b><i>Independent Auditors' Report</i></b>	1
<b><i>Financial Statements</i></b>	
<i>Statement of Financial Position</i>	2
<i>Statement of Activities</i>	3
<i>Statement of Cash Flows</i>	4
<i>Notes to Financial Statements</i>	5 - 17

## 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 September 30, 2014, and the related statements of activities and cash flows for the nine month period then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ***The Mariners' Museum*** as of September 30, 2014, and the changes in its net assets and its cash flows for the nine month period then ended in accordance with accounting principles generally accepted in the United States of America.

*Dixon Hughes Goodman LLP*

Newport News, Virginia  
June 3, 2015

# ***The Mariners' Museum***

## ***Statement of Financial Position***

**September 30, 2014**

<b>Assets</b>	
<b>Current assets</b>	
Cash and cash equivalents	
Unrestricted	\$ 2,353,332
Restricted (Note 3)	1,444,306
Certificates of deposit	1,389,228
Accounts receivable	9,971
Current portion of pledges receivable (Note 4)	829,069
Inventories	240,142
Other current assets	158,566
	<hr/>
<b>Total current assets</b>	6,424,614
	<hr/>
<b>Property and equipment - net (Note 6)</b>	30,687,495
	<hr/>
<b>Other assets</b>	
Investments	
Investments (Note 5)	16,275,950
Beneficial interest in trusts (Note 7)	89,751,137
Pledges receivable - less current portion (Note 4)	669,403
	<hr/>
<b>Total other assets</b>	106,696,490
	<hr/>
	<b>\$ 143,808,599</b>
	<hr/>
<b>Liabilities and Net Assets</b>	
<b>Current liabilities</b>	
Accounts payable	\$ 180,281
Accrued expenses	430,107
	<hr/>
<b>Total current liabilities</b>	610,388
<b>Long-term liabilities</b>	
Charitable gift annuities (Note 9)	76,807
Bond payable (Note 11)	9,600,000
Deferred revenue (Note 10)	6,078,540
	<hr/>
<b>Total liabilities</b>	16,365,735
	<hr/>
<b>Net assets</b>	
Unrestricted	34,907,498
Temporarily restricted (Note 12)	2,189,196
Permanently restricted (Note 12)	90,346,170
	<hr/>
<b>Total net assets</b>	127,442,864
	<hr/>
	<b>\$ 143,808,599</b>
	<hr/>

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

## The Mariners' Museum

### Statement of Activities

Nine Month Period Ended September 30, 2014	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenue, gains and support</b>				
Income from funds held in trust by others	\$ 3,135,521	\$ -	\$ -	\$ 3,135,521
Realized and unrealized gains on investments - net	394,048	16,307	632,498	1,042,853
Contributions	309,291	198,116	-	507,407
Admission fees	348,071	-	-	348,071
Miscellaneous	235,329	9,365	-	244,694
Dividend and interest income - net	102,517	49,417	2,689	154,623
Lease	143,775	-	-	143,775
Grants	132,422	-	-	132,422
Museum shop	130,340	-	-	130,340
Facility rental	79,747	-	-	79,747
Education program fees	71,838	-	-	71,838
Photography	31,012	-	-	31,012
Chris Craft	24,158	-	-	24,158
Boat house	3,875	-	-	3,875
Deaccession	1,186	-	-	1,186
Publications	117	-	-	117
Change in valuation of charitable gift annuities	-	-	(5,728)	(5,728)
Net assets released from restrictions	867,844	(867,844)	-	-
<b>Total revenue, gains and support</b>	<b>6,011,091</b>	<b>(594,639)</b>	<b>629,459</b>	<b>6,045,911</b>
<b>Program expenses</b>				
Exhibit design and production	804,510	-	-	804,510
Curatorial and conservation	470,994	-	-	470,994
Marketing and special events	454,125	-	-	454,125
Admissions	306,197	-	-	306,197
Library and archives	246,865	-	-	246,865
Education	211,334	-	-	211,334
Collection management	160,823	-	-	160,823
Museum shop	124,418	-	-	124,418
Photography	108,745	-	-	108,745
Park and Noland Trail	61,904	-	-	61,904
Chris Craft	22,087	-	-	22,087
Facilities management	15,544	-	-	15,544
Publications and graphic design	10,114	-	-	10,114
<b>Total program expenses</b>	<b>2,997,660</b>	<b>-</b>	<b>-</b>	<b>2,997,660</b>
<b>Supporting expenses</b>				
General administration	2,673,433	-	-	2,673,433
Facilities management	1,596,909	-	-	1,596,909
Development and membership	471,137	-	-	471,137
Museum shop	5,184	-	-	5,184
<b>Total supporting expenses</b>	<b>4,746,663</b>	<b>-</b>	<b>-</b>	<b>4,746,663</b>
<b>Total expenses</b>	<b>7,744,323</b>	<b>-</b>	<b>-</b>	<b>7,744,323</b>
<b>Change in net assets</b>	<b>(1,733,232)</b>	<b>(594,639)</b>	<b>629,459</b>	<b>(1,698,412)</b>
<b>Net assets - beginning of year</b>	<b>36,640,730</b>	<b>2,783,835</b>	<b>89,716,711</b>	<b>129,141,276</b>
<b>Net assets - end of year</b>	<b>\$34,907,498</b>	<b>\$ 2,189,196</b>	<b>\$90,346,170</b>	<b>\$ 127,442,864</b>

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

## ***The Mariners' Museum***

### ***Statement of Cash Flows***

---

**Nine Month Period Ended September 30, 2014**

---

#### **Cash flows from operating activities**

Change in net assets	\$(1,698,412)
Adjustments to reconcile to net cash from operating activities:	
Depreciation	1,312,461
Change in allowance for uncollectible pledges	(8,848)
Unrealized gains on investments:	
Funds held in trust by others	(619,415)
Investments	(343,753)
Realized gains on investments	(79,685)
Change in valuation of charitable gift annuities	5,728
Change in:	
Accounts receivable	(5,663)
Pledges receivable	579,321
Inventories	(22,880)
Other current assets	184,177
Accounts payable	61,499
Accrued expenses	2,316
Deferred revenue	203,146
<b>Net cash from operating activities</b>	<u>(430,008)</u>

#### **Cash flows from investing activities**

Property and equipment acquisitions	(84,075)
Sales and maturities of investments	647,323
Purchases of investments	(513,092)
<b>Net cash from investing activities</b>	<u>50,156</u>

#### **Cash flows from financing activities**

Payments on charitable gift annuities	<u>(14,606)</u>
---------------------------------------	-----------------

**Net change in cash and cash equivalents** (394,458)

**Cash and cash equivalents - beginning of year** 4,192,096

**Cash and cash equivalents - end of year** \$ 3,797,638

#### **Supplemental disclosure of cash flow information**

Cash paid for interest	\$ 197,898
------------------------	------------

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

# ***The Mariners' Museum***

## ***Notes to Financial Statements***

---

**September 30, 2014**

---

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

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

The stated mission of ***The Mariners' Museum*** is to make a difference in peoples' lives, inviting them to discover their relationship to the sea by exploring maritime culture, science and history. ***The Mariners' Museum*** uses its art and artifacts to educate local, national and international audiences of all ages about the vital role of the sea in mankind's development. The Museum aspires to be the leader in promoting an appreciation of the maritime world - past, present and future. The Mariners' Museum Park and Lake Maury offer the residents of and visitors to the area the opportunity to experience the beauty and peace of an oasis in the city, to enjoy healthy exercise on the Noland Trail and to enhance their appreciation of the natural habitat of the park.

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

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

#### **Accounting Method**

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

#### **Basis of Presentation**

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

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

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

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

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

### **Cash and Cash Equivalents**

The Museum considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents. Included in cash and cash equivalents balances are amounts restricted, primarily for future property and equipment acquisitions.

### **Certificates of Deposit**

Some cash has been invested in certificates of deposit, which mature at various times and earns interest at various rates. Certificates of deposit are stated at cost plus accrued interest earned.

### **Inventories**

Inventories consist of gift shop items and publications and are stated at the lower of cost (determined using the first-in, first-out method) or market. Inventory related to the Museum Shop was \$197,635 at September 30, 2014, and publications inventory was \$47,230 at September 30, 2014. At September 30, 2014, a valuation allowance of \$4,723 was recorded for slow-moving publications inventory.

### **Investments**

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 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 statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

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



## Property and Equipment

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

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

Maintenance and ordinary repairs are expensed; improvements are capitalized. Gains and losses arising from disposal or retirement of property and equipment are recognized currently in the accompanying statement of activities and the cost and related accumulated depreciation, if applicable, are removed from the accounts. For 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 statement of financial position. Only current year purchases and proceeds from sale are reflected in the statement of activities. It is the policy of the Museum that proceeds from the sale of any collection items are to be used for the acquisition of objects for the permanent collections or for the conservation or maintenance of items currently owned by the Museum by external conservators.

## Pledges Receivable

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

## In-Kind Contributions and Donated Services

The Museum received in-kind contributions of \$17,780 in 2014. These contributions were primarily related to advertising and artifacts. Additionally, the Museum received volunteer hours of 18,285 in 2014. No amounts have been recognized in the statement of activities for donated services because the criteria for recognition under applicable accounting standards have not been satisfied.

## Restricted Contributions

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

## **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 \$200,089 for 2014, excluding donated advertising and is included in marketing and special events and admissions expense on the statement of activities.

## **Income Taxes**

The Museum is a nonstock corporation which has been determined by the Internal Revenue Service to be exempt from taxes on income derived from activities related to its exempt purpose under Section 501(c)(3) of the Internal Revenue Code. The Museum is subject to income taxes on profits, if any, generated from the sale of items in its gift shop which are unrelated to its exempt purpose. The Internal Revenue Service has also determined that the Museum is not a private foundation under Section 509(a)(1). The Museum has determined that it does not have any material unrecognized tax benefits or obligations as of September 30, 2014. Calendar years ending on or after December 31, 2011, 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. At September 30, 2014, the Museum had approximately \$2.8 million of cash and cash equivalents on deposit with financial institutions in excess of the Federal Deposit Insurance Corporation (FDIC) limit.

## **Subsequent Events**

In preparing these financial statements, the Museum has evaluated events and transactions for potential recognition or disclosure through June 3, 2015, the date the financial statements were available to be issued.

### 3. Restricted Cash

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

Maritime Galleries and Exhibit Funding	<u>\$ 1,444,306</u>
--	---------------------

### 4. Pledges Receivable

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

The Monitor Center campaign	\$ 1,407,867
General operating and library support	<u>90,605</u>
	<u>\$ 1,498,472</u>

The anticipated cash flows from pledges receivable is as follows:

Receivable in less than one year	\$ 829,069
Receivable in one to five years	<u>879,466</u>
Total pledges receivable	1,708,535
Less - discounts to net realizable value	(25,063)
Less - allowance for uncollectible pledges	<u>(185,000)</u>
	1,498,472
Less - current portion	<u>(829,069)</u>
	<u>\$ 669,403</u>

At September 30, 2014, the discount rates used ranged from 1.52% to 4.51%.

### 5. Investments

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

Equity securities	\$ 6,650,422
Bonds	6,900,204
Mortgage-backed securities	1,442,075
Money funds	699,709
Real estate securities	<u>583,540</u>
	<u>\$ 16,275,950</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 statement of activities, net of investment management fees.

At September 30, 2014 fair values and unrealized gains are summarized as follows:

	Cost	Fair Value	Unrealized Gain
Frank Russell Investment Company	\$ 12,715,912	\$ 14,779,941	\$ 2,064,029
UBS Commercial Services, Inc.	1,428,141	1,444,306	16,165
Wells Fargo Advisors, LLC	49,366	51,703	2,337
	<u>\$ 14,193,419</u>	<u>\$ 16,275,950</u>	<u>\$ 2,082,531</u>

## 6. Property and Equipment

Property and equipment consist of the following:

Building and improvements	\$ 50,799,636
Furniture and equipment	6,393,891
Land improvements	4,656,952
The Noland Trail	2,219,802
Lakes, dams and improvements	626,901
	<u>64,697,182</u>
Less - accumulated depreciation	<u>(34,009,687)</u>
	<u>\$ 30,687,495</u>

Depreciation expense for 2014 was \$1,312,461.

## 7. Beneficial Interest in Trusts

The Museum is the beneficiary of various irrevocable trusts established by the Museum founder, Archer M. Huntington, which are classified as permanently restricted. The Museum receives distributions on the securities held by the trusts. These distributions are reported in the accompanying statement of activities, net of expenses and is included in income from funds held in trust by others. The Museum paid management fees to JP Morgan Chase Bank of \$48,709 in 2014.

At September 30, 2014, the value recorded for the beneficial interest in trusts is comprised of the following:

JP Morgan Chase Bank Trust #03152009	\$ 46,412,889
JP Morgan Chase Bank Trust #03583005	31,687,666
JP Morgan Chase Bank Trust #98940006	3,414,300
JP Morgan Chase Bank Trust #98843002	2,664,110
JP Morgan Chase Bank Trust #03152306	1,501,615
JP Morgan Chase Bank Trust #03583302	1,001,961
SunTrust Bank Trust #13214200	1,905,147
Bank of America (formerly U.S. Trust Co. of New York #239550)	805,303
Bank of New York #676580	179,600
Bank of New York #676730	100,326
Bank of New York #676760	78,220
	<u>\$ 89,751,137</u>

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 2014, the Board of Trustees approved a temporary increase to the total return policy which allowed the Museum to receive distributions based upon 5% of the preceding twelve quarters rolling average of the fair market value of the trusts. The remaining trusts also pay out 5% 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 statement of financial position is 25% of the trust's value, which represents the Museum's share under this split-interest agreement.

## **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 April 1, 2014, the Museum makes an elective matching contribution of 2% of eligible compensation. The Museum contributed \$27,627 to the Plan during 2014.

## **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 \$76,807 at September 30, 2014. The discount rates used to calculate the fair value ranged from 4.20% to 7.60% for 2014. At September 30, 2014, assets of \$346,209 were held in a charitable gift annuities investment account, which is included in investments on the statement of financial position.

## **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 \$3,269,895 at September 30, 2014

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 \$38,772 in 2014. The Museum deferred the principal payments, which will be recognized at the end of the lease term. The deferred amount is \$2,421,105 at September 30, 2014.

The third lease agreement commenced on December 1, 2010, and was for an initial term of 20 years. The rent for the initial term was \$65,000, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 and 30 years, respectively, by making payments upon exercise of those options in the amount of \$25,000 and \$20,000, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$3,250 annually over the first 20 years, through 2030, \$1,250 annually for the next 20 years, 2030 - 2050, and \$667 annually for the final 30 years, 2050 - 2080. The deferred amount is \$97,542 at September 30, 2014.

During 2012, the Museum entered into a fourth lease agreement, similar to the above. The lease commenced on May 1, 2012, and was for an initial term of 18.5 years. The rent for the initial term was \$143,780, paid upon the commencement of the lease. The lessee had two options to renew the lease for 20 and 30 years, respectively, by making payments upon exercise of those options in the amount of \$65,492 and \$42,650, respectively. The lessee has chosen to exercise both options by making the payments with respect to those options. The term of the lease now ends on November 30, 2080. The Museum has deferred recognition of the amount received, and is amortizing the revenue over the lease term at the following rates, \$7,772 annually over the first 18.5 years, through 2030, \$3,275 annually for the next 20 years, 2030 - 2050, and \$1,422 annually for the final 30 years, 2050 - 2080. The deferred amount is \$233,140 at September 30, 2014. Additionally, the Museum had various deferred amounts of \$56,858 at September 30, 2014.

## **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 was unsecured. The Museum has used the proceeds from the bond to finance the 65,000 square foot expansion of the Museum called the USS *Monitor* Center.

On February 1, 2012, the Museum refinanced the bond arrangement. Under the new agreement with the Economic Development Authority of Lancaster County, Virginia, the Museum was issued a \$9,600,000 fixed rate bank qualified tax-exempt bond, which is unsecured. This new bond issue retired the existing debt. The bond bears interest at a fixed rate of 2.7% and accrued interest on the unpaid principal balance is due monthly through April 1, 2027. On April 1, 2018, the Museum will begin annual principal payments of \$960,000 through April 1, 2027, when the bond is due and payable in full. Interest expense related to these bonds was \$196,560 for 2014.

## 12. Net Asset Restrictions

Temporarily restricted net assets are available for the following purposes:

Program restrictions	<u>\$ 2,189,196</u>
----------------------	---------------------

Permanently restricted net assets are invested to:

Beneficial interest in trusts, a portion of the spending rate which is available to support operations	\$ 89,751,137
Endowment funds	<u>595,033</u>
	<u>\$ 90,346,170</u>

During 2014, \$867,844 of temporarily restricted net assets were released from restrictions and used to fund the Savage Ancient Seas exhibition, Explorer Theater and various other gallery upgrades that satisfied donor restrictions.

## 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 September 30, 2014.

*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 September 30, 2014</b>				
	Level 1	Level 2	Level 3	Total
Trading securities:				
Mutual funds - bonds / fixed income	\$ 6,900,203	\$ -	\$ -	\$ 6,900,203
Mutual funds - international	1,166,498	-	-	1,166,498
Mutual funds - real estate	583,540	-	-	583,540
Mutual funds - equity - other	5,483,924	-	-	5,483,924
Money funds	699,710	-	-	699,710
Fixed income:				
Residential mortgage-backed securities	-	-	1,442,075	1,442,075
	<u>14,833,875</u>	-	<u>1,442,075</u>	<u>16,275,950</u>
Pledges receivable	-	-	1,498,472	1,498,472
Beneficial interest in trusts	-	-	89,751,137	89,751,137
Total assets at fair value	<u>\$ 14,833,875</u>	<u>\$ -</u>	<u>\$ 92,691,684</u>	<u>\$ 107,525,559</u>



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

	Residential Mortgage- backed Securities	Pledges Receivable	Beneficial Interest in Trusts
<b>Balance - December 31, 2013</b>	\$ 1,395,788	\$ 2,068,945	\$ 89,131,722
Total gains and losses included in change in net assets	2,838	-	-
Interest and dividends	45,680	-	-
Investment sales	(384,044)	-	-
Investment purchases	381,813	-	-
New pledges	-	383,322	-
Pledge collections	-	(897,763)	-
Pledges written off	-	(64,880)	-
Changes in discount and allowance	-	8,848	-
Adjustment to fair value	-	-	619,415
<b>Balance - September 30, 2014</b>	<b>\$ 1,442,075</b>	<b>\$ 1,498,472</b>	<b>\$ 89,751,137</b>

#### 14. Donor-Designated Endowments

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

The Endowment includes two general categories of funds. One category of funds is donor-restricted funds that are restricted for a particular purpose. The second category of funds is composed of receipts from long-term rentals of real estate (primarily described in Note 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 September 30, 2014, are presented below.

Donor-designated endowment net asset composition is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor restricted endowment funds	\$ -	\$ -	\$ 595,033	\$ 595,033

Changes in endowment net assets were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets - beginning of year	\$ -	\$ -	\$ 584,989	\$ 584,989
Net appreciation	-	-	10,044	10,044
Endowment net assets - end of	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 595,033</u>	<u>\$ 595,033</u>

## 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:

2015	\$ 2,500
2016	2,500
2017	2,500
2018	2,500
2019	2,500
Thereafter	<u>12,500</u>
	<u>\$ 25,000</u>

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

\* \* \* \* \*