

FINANCIAL STATEMENTS



CHESAPEAKE BAY FOUNDATION

Saving a National Treasure

**FOR THE YEAR ENDED JUNE 30, 2017
WITH SUMMARIZED FINANCIAL
INFORMATION FOR 2016**

CHESAPEAKE BAY FOUNDATION, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Chesapeake Bay Foundation, Inc.
Annapolis, Maryland

We have audited the accompanying financial statements of the Chesapeake Bay Foundation, Inc. (the Foundation), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and change in net assets, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's 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 auditor's 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 Foundation as of June 30, 2017, and the change in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Report on Summarized Comparative Information

We have previously audited the Foundation's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 14, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Summary of Conservation and Scenic Easements on page 30, which is the responsibility of management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

A handwritten signature in cursive script that reads "Gelman Rosenberg & Freedman".

December 14, 2017

CHESAPEAKE BAY FOUNDATION, INC.
STATEMENT OF FINANCIAL POSITION
AS OF JUNE 30, 2017
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2016

ASSETS

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 9,984,436	\$ 4,966,040
Investments	57,758,141	57,231,749
Accounts receivable, less allowance for doubtful accounts of \$2,852 and \$1,909 for 2017 and 2016, respectively	759,675	843,584
Note receivable	84,822	87,013
Pledges receivable, net of allowance for doubtful accounts of \$102,270 and \$123,774 for 2017 and 2016, respectively	9,173,036	11,676,703
Prepays, deposits and other assets	837,583	651,495
Property and equipment, net of accumulated depreciation and amortization of \$18,270,258 and \$17,071,657 for 2017 and 2016, respectively	<u>31,043,455</u>	<u>31,007,554</u>
TOTAL ASSETS	<u>\$109,641,148</u>	<u>\$106,464,138</u>

LIABILITIES AND NET ASSETS

LIABILITIES

Loan payable	\$ 1,417,571	\$ 2,408,828
Bonds payable	4,244,019	4,789,103
Accounts payable and accrued expenses	2,075,956	1,740,573
Deferred income	1,027,160	863,126
Liability under split interest agreements	813,779	840,555
Interest rate swap obligation	<u>438,167</u>	<u>721,368</u>
Total liabilities	<u>10,016,652</u>	<u>11,363,553</u>

NET ASSETS

Unrestricted	33,689,681	31,759,859
Temporarily restricted	19,661,940	17,233,727
Permanently restricted	<u>46,272,875</u>	<u>46,106,999</u>
Total net assets	<u>99,624,496</u>	<u>95,100,585</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$109,641,148</u>	<u>\$106,464,138</u>

CHESAPEAKE BAY FOUNDATION, INC.

**STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2017
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2016**

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
REVENUE					
Membership contributions	\$ 4,949,035	\$ -	\$ -	\$ 4,949,035	\$ 4,535,112
Grants and gifts	8,314,929	7,653,759	-	15,968,688	16,925,926
Education contracts and tuition	1,055,752	-	-	1,055,752	1,093,983
Investment distribution	591,530	2,177,434	-	2,768,964	2,768,395
Donated goods and services	1,255,568	-	-	1,255,568	1,191,947
Other	772,883	-	-	772,883	918,063
Net assets released from donor restrictions	<u>10,004,859</u>	<u>(10,004,859)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total revenue	<u>26,944,556</u>	<u>(173,666)</u>	<u>-</u>	<u>26,770,890</u>	<u>27,433,426</u>
EXPENSES					
Program Services:					
Environmental Education	6,583,700	-	-	6,583,700	6,334,976
Environmental Protection and Restoration	11,290,038	-	-	11,290,038	11,436,224
Strategic Communications	<u>3,090,621</u>	<u>-</u>	<u>-</u>	<u>3,090,621</u>	<u>3,288,085</u>
Total program services	<u>20,964,359</u>	<u>-</u>	<u>-</u>	<u>20,964,359</u>	<u>21,059,285</u>
Support Services:					
General and Administrative	2,289,329	-	-	2,289,329	2,172,742
Fundraising	<u>3,506,414</u>	<u>-</u>	<u>-</u>	<u>3,506,414</u>	<u>3,357,652</u>
Total support services	<u>5,795,743</u>	<u>-</u>	<u>-</u>	<u>5,795,743</u>	<u>5,530,394</u>
Total expenses	<u>26,760,102</u>	<u>-</u>	<u>-</u>	<u>26,760,102</u>	<u>26,589,679</u>
Change in net assets before capital additions (deductions)	<u>184,454</u>	<u>(173,666)</u>	<u>-</u>	<u>10,788</u>	<u>843,747</u>
CAPITAL ADDITIONS (DEDUCTIONS)					
Investment gain (loss) and distributions, net	1,461,530	2,601,879	131,712	4,195,121	(3,091,216)
Grants and gifts	-	-	34,164	34,164	1,326,720
Gain on sale of property and equipment	637	-	-	637	-
Unrealized gain on interest rate swap	<u>283,201</u>	<u>-</u>	<u>-</u>	<u>283,201</u>	<u>22,701</u>
Total capital additions (deductions)	<u>1,745,368</u>	<u>2,601,879</u>	<u>165,876</u>	<u>4,513,123</u>	<u>(1,741,795)</u>
Change in net assets	1,929,822	2,428,213	165,876	4,523,911	(898,048)
Net assets at beginning of year	<u>31,759,859</u>	<u>17,233,727</u>	<u>46,106,999</u>	<u>95,100,585</u>	<u>95,998,633</u>
NET ASSETS AT END OF YEAR	<u>\$ 33,689,681</u>	<u>\$ 19,661,940</u>	<u>\$ 46,272,875</u>	<u>\$ 99,624,496</u>	<u>\$ 95,100,585</u>

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2017
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2016

	Program Services			2017
	Environmental Education	Environmental Protection and Restoration	Strategic Communications	Total Program Services
Salaries	\$ 2,545,614	\$ 4,272,518	\$ 1,125,661	\$ 7,943,793
Fringe benefits	983,921	1,635,282	442,703	3,061,906
Supplies	310,784	246,992	54,065	611,841
Restoration supplies	120	172,496	88	172,704
Telephone	46,849	68,336	8,564	123,749
Postage and shipping	114,826	202,456	92,650	409,932
Occupancy and utilities	405,152	935,261	126,857	1,467,270
Equipment rental, leasing, repairs and maintenance	289,748	220,253	42,264	552,265
Printing and publications	155,232	308,700	128,089	592,021
Dues and subscriptions	1,251	22,032	6,358	29,641
Travel	236,977	196,099	13,010	446,086
Meetings and seminars	133,234	85,465	17,685	236,384
Outside services	51,235	260,293	88,411	399,939
Professional fees	261,563	896,942	310,375	1,468,880
Restoration fees	-	395,663	-	395,663
Personnel recruitment	865	-	-	865
Miscellaneous	15,350	29,925	1,090	46,365
Mailing preparation	35,314	60,558	16,578	112,450
Insurance	161,727	122,902	14,056	298,685
List rentals	38,665	66,304	18,151	123,120
Depreciation and amortization	185,780	196,873	20,985	403,638
Subrecipients	-	123,286	-	123,286
Donated goods and services	385,353	387,035	457,761	1,230,149
Sub-total	6,359,560	10,905,671	2,985,401	20,250,632
Allocation of management and general	224,140	384,367	105,220	713,727
TOTAL	\$ 6,583,700	\$ 11,290,038	\$ 3,090,621	\$ 20,964,359

Support Services					2016
General and Administrative	Fundraising	Total Support Services	Total Expenses	Total Expenses	
\$ 1,777,350	\$ 1,274,539	\$ 3,051,889	\$ 10,995,682	\$ 10,565,362	
646,795	498,597	1,145,392	4,207,298	4,076,786	
33,643	54,070	87,713	699,554	593,254	
-	-	-	172,704	203,124	
4,306	11,765	16,071	139,820	165,523	
1,722	140,205	141,927	551,859	664,288	
273,739	81,140	354,879	1,822,149	1,792,851	
20,589	72,838	93,427	645,692	533,641	
1,515	316,171	317,686	909,707	787,931	
5,738	4,625	10,363	40,004	51,331	
40,672	24,072	64,744	510,830	474,846	
78,240	129,130	207,370	443,754	432,603	
7,522	228,021	235,543	635,482	489,809	
133,945	371,449	505,394	1,974,274	2,604,788	
-	-	-	395,663	247,625	
26,411	-	26,411	27,276	28,573	
14,048	12,557	26,605	72,970	116,825	
-	67,442	67,442	179,892	179,708	
46,373	21,158	67,531	366,216	360,002	
-	29,517	29,517	152,637	142,471	
9,027	25,120	34,147	437,785	357,546	
-	-	-	123,286	528,845	
650	24,769	25,419	1,255,568	1,191,947	
3,122,285	3,387,185	6,509,470	26,760,102	26,589,679	
(832,956)	119,229	(713,727)	-	-	
\$ 2,289,329	\$ 3,506,414	\$ 5,795,743	\$ 26,760,102	\$ 26,589,679	

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2017
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 4,523,911	\$ (898,048)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,261,187	1,209,626
Unrealized gain on interest rate swap	(283,201)	(22,701)
Gain on sale of property and equipment	(637)	-
Capital additions - permanently restricted contributions	(34,164)	(1,326,720)
Change in the discount of long-term pledges receivable	(176,220)	(828,134)
Change in allowance for doubtful accounts	(20,561)	(15,149)
Unrealized (gain) loss on investments	(6,343,991)	1,825,422
Realized gains on investments	(294,752)	(456,770)
Change in value of split interest agreements	58,103	11,790
Decrease (increase) in:		
Accounts receivable	82,966	653,420
Pledges receivable	2,701,391	793,022
Prepays, deposits and other assets	(186,088)	33,864
Increase (decrease) in:		
Accounts payable and accrued expenses	335,383	34,911
Deferred income	164,034	347,882
Liability under split interest agreements	(9,477)	-
Net cash provided by operating activities	<u>1,777,884</u>	<u>1,362,415</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net sales (purchases) of investments	6,112,351	(3,286,794)
Purchases of property and equipment	(1,278,057)	(1,713,950)
Proceeds from note receivable	2,191	1,719
Net cash provided (used) by investing activities	<u>4,836,485</u>	<u>(4,999,025)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital additions - permanently restricted contributions	34,164	1,326,720
Payments on bonds payable	(554,735)	(524,936)
Payments on loan payable	(1,000,000)	(2,600,000)
Proceeds from split interest agreements	-	29,217
Payments made on split interest agreements	(75,402)	(79,063)
Net cash used by financing activities	<u>(1,595,973)</u>	<u>(1,848,062)</u>

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2017
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2016

	<u>2017</u>	<u>2016</u>
Net increase (decrease) in cash and cash equivalents	\$ 5,018,396	\$ (5,484,672)
Cash and cash equivalents at beginning of year	<u>4,966,040</u>	<u>10,450,712</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 9,984,436</u>	<u>\$ 4,966,040</u>
 SUPPLEMENTAL INFORMATION		
Interest Paid	<u>\$ 294,995</u>	<u>\$ 345,512</u>
Taxes Paid	<u>\$ 316</u>	<u>\$ 22,366</u>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION

Organization -

The Chesapeake Bay Foundation, Inc. (the Foundation) is a non-profit organization, incorporated in the State of Maryland in March 1966. Its principal sources of funds are contributions received directly from the public and grants received from individuals, foundations, governments, and corporations for environmental education, environmental protection, and land management and conservation programs relating to the Chesapeake Bay Region.

Basis of presentation -

The accompanying financial statements are presented on the accrual basis of accounting, and in accordance with FASB ASC 958, *Not-for-Profit Entities*.

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2016, from which the summarized information was derived.

Cash and cash equivalents -

The Foundation considers all cash and other highly liquid investments, including certificates of deposit with maturities of three months or less, and excluding cash and cash equivalents held by investment managers, to be cash equivalents.

Bank deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a limit of \$250,000. At times during the year the Foundation maintains cash balances in excess of the FDIC insurance limits. Management believes the risk in these situations to be minimal.

Investments -

The Foundation invests in shares held in individual securities or investment funds which include bonds, stocks, investment trusts, money market funds held for investment purposes, and limited partnerships. Investment fund managers trade in various domestic and foreign financial markets, which carry a certain amount of risk of loss. Investments are stated at fair value based on quoted market prices at the reporting date, or in absence of such quoted market price, a reasonable estimate of fair value as approved by management. Unrealized and realized gains and losses are included in investment (loss) return and investment income in the Statement of Activities and Change in Net Assets.

The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. Credit risk from financial instruments relates to the possibility that invested assets within a particular industry segment may experience loss due to market conditions. The Foundation has diversified its financial instruments to help ensure that no one industry segment represents a significant concentration of risk.

Although management uses its best judgment at estimating fair value of the underlying assets for its investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of fair value could be material.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION
(Continued)**

Financial instruments with off-balance sheet risk -

In the course of trading activities entered into by the Foundation's various investment fund managers, certain financial instruments with off-balance sheet risk were acquired in order to structure the portfolio transactions to economically match the investment objectives of the funds and to hedge market risk. The exposure to credit risk associated with non-performance of any of these types of financial instruments is typically limited to the value of such investments reported as assets in the Statement of Financial Position.

Accounts and pledges receivable -

Accounts receivable are recorded at their net realizable value, which approximates fair value. Pledges receivable that are expected to be collected in future years are recorded at fair value, measured as the present value of their future cash flows. The discounts on these amounts are computed using risk-adjusted interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in grants and gifts revenue. Conditional promises to give are not included as support until the conditions are substantially met. The allowance for doubtful accounts is determined based upon an annual review of account balances, including the age of the balance and the historical experience with the customer and donor.

Deferred financing costs -

Deferred financing costs represent loan issuance and bond issuance costs and other costs related to the construction of the Brock Environmental Center and the acquisition of the Bay Ridge Facility (Notes 7 and 8). Deferred financing costs are being amortized over the respective lives of the loan and bonds. Deferred financing costs are shown net of loan and bonds payable on the accompanying Statement of Financial Position.

Property and equipment -

Property and equipment are stated at acquisition cost or fair market value at the date of donation, less accumulated depreciation. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the related assets, generally three to thirty years. The Foundation has established \$5,000 as its threshold for capitalization.

Land is stated at acquisition cost, fair market value, or if fair market value is not available, at assessment value, at the date of donation. The land is used for educational, conservation, and operating purposes.

The cost of maintenance and repairs is recorded as expenses are incurred.

Impairment of long-lived assets -

Management reviews asset carrying amounts whenever events or circumstances indicate that such carrying amounts may not be recoverable. When considered impaired, the carrying amount of the assets is reduced, by a charge to Statement of Activities and Change in Net Assets, to its current fair value.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION**
(Continued)

Split interest agreements -

A split interest agreement is a trust or other arrangements initiated by donors under which the Foundation receives benefits that are shared with either the donor or third party beneficiaries.

The Foundation is the beneficiary of several split interest agreements. The Foundation's interest in these split interest agreements is reported as a contribution in the year received at its net present value. For the years ended June 30, 2017 and 2016, liabilities under split interest agreements totaled \$813,779 and \$840,555, respectively.

Net asset classification -

The net assets of the Foundation are reported in three self-balancing groups as follows:

- ! **Unrestricted net assets** include unrestricted revenue and contributions received without donor-imposed restrictions. These net assets are available for the operation of the Foundation and include both internally designated and undesignated resources.
- ! **Temporarily restricted net assets** include revenue and contributions subject to donor-imposed stipulations that will be met by the actions of the Foundation and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities and Change in Net Assets as net assets released from restrictions.
- ! **Permanently restricted net assets** represent funds restricted by the donor to be maintained in-perpetuity by the Foundation. There are restrictions placed on the use of investment earnings from these endowment funds.

Contributions, grants and gifts -

Contributions, grants and gifts are recorded as revenue in the year notification is received from the donor. Temporarily restricted contributions and grants are recognized as unrestricted support only to the extent of actual expenses incurred in compliance with the donor-imposed restrictions and satisfaction of time restrictions. Such contributions, grants and gifts received in excess of expenses incurred are shown as temporarily restricted net assets in the accompanying financial statements.

The Foundation receives funding under grants and contracts from the U.S. Government for direct and indirect program costs. This funding is subject to contractual restrictions, which must be met through incurring qualifying expenses for particular programs. Accordingly, such grants are considered exchange transactions and are recorded as unrestricted grant revenue to the extent that related expenses are incurred in compliance with the criteria stipulated in the grant agreements.

Grants and support receivable represents amounts due from funding organizations for reimbursable expenses incurred in accordance with the grant agreements. Grant funding received in advance of incurring the related expenses is recorded as a refundable advance.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION**
(Continued)

Donated goods and services -

Contributions of goods or services are recognized when they are received if the goods or services either (a) create or enhance non-financial assets, or (b) require specialized skills, and are provided by individuals possessing those skills, and would typically need to be purchased if not donated. These amounts are shown as revenue and expenses on the Statement of Activities and Change in Net Assets.

Income taxes -

The Foundation is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Foundation is not a private foundation. The Foundation is required to report unrelated business income to the Internal Revenue Service and the appropriate state taxing authorities. The Foundation has recorded income tax expense of \$316 and \$22,366 for the years ended June 30, 2017 and 2016, respectively, as follows:

	<u>2017</u>	<u>2016</u>
Other Unrelated Business Income Tax Included as an Addition to Miscellaneous Expenses in the Accompanying Statement of Functional Expenses	\$ <u>316</u>	\$ <u>22,366</u>

Uncertain tax positions -

For the years ended June 30, 2017 and 2016, the Foundation has documented its consideration of FASB ASC 740-10, *Income Taxes*, that provides guidance for reporting uncertainty in income taxes and has determined that no material uncertain tax positions qualify for either recognition or disclosure in the financial statements.

Use of estimates -

The preparation of the 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 at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Fair value measurement -

The Foundation adopted the provisions of FASB ASC 820, *Fair Value Measurement*. FASB ASC 820 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs (assumptions that market participants would use in pricing assets and liabilities, including assumptions about risk) used to measure fair value, and enhances disclosure requirements for fair value measurements. The Foundation accounts for a significant portion of its financial instruments at fair value or considers fair value in their measurement.

Functional allocation of expenses -

The costs of providing the various programs and other activities have been summarized on a functional basis in the Statement of Activities and Change in Net Assets.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION
(Continued)

Functional allocation of expenses (continued) -

Accordingly, certain costs have been allocated among the programs and support services benefited.

Joint costs -

For fiscal years 2017 and 2016, the Foundation incurred joint costs of \$2,328,695 and \$2,194,443, respectively, for educational materials, membership and support services. These costs were allocated as follows:

	<u>2017</u>	<u>2016</u>
Environmental Education	\$ 560,816	\$ 474,025
Environmental Protection and Restoration	961,715	855,734
Strategic Communications	263,267	246,036
Fundraising	<u>542,897</u>	<u>618,648</u>
TOTAL JOINT COSTS INCURRED	<u>\$ 2,328,695</u>	<u>\$ 2,194,443</u>

Reclassification -

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation. These reclassifications had no effect on the previously reported changes in net assets.

New accounting pronouncements -

In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-03 related to *Simplifying the Presentation of Debt Issuance Costs*, as part of its simplification initiative. The ASU changes the presentation of debt issuance costs in the financial statements. Under the ASU, an entity presents such costs in the Statement of Financial Position as a direct deduction from the related debt liability, rather than as an asset. Amortization of the costs is reported as interest expense. The guidance in the ASU is effective for fiscal years beginning after December 15, 2015. During the year ended June 30, 2017, the Foundation adopted the new guidance above and applied it retrospectively.

In 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820). The ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The ASU becomes effective for years beginning after December 15, 2016. Early adoption is permitted. The ASU should be applied on a retrospective basis in the year the ASU is first applied. During the year ended June 30, 2017, the Foundation adopted the new guidance above and applied it retrospectively.

New accounting pronouncements not yet adopted -

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958), intended to improve financial reporting for not-for-profit entities.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

New accounting pronouncements not yet adopted (continued) -

The ASU will reduce the current three classes of net assets into two: with and without donor restrictions. The change in each of the classes of net assets must be reported on the Statement of Activities and Change in Net Assets. The ASU also requires various enhanced disclosures around topics such as board designations, liquidity, functional classification of expenses, investment expenses, donor restrictions, and underwater endowments. The ASU is effective for years beginning after December 15, 2017. Early adoption is permitted. The ASU should be applied on a retrospective basis in the year the ASU is first applied. While the ASU will change the presentation of the Foundation's financial statements, it is not expected to alter the Foundation's reported financial position.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606) (ASU 2014-09). The ASU establishes a comprehensive revenue recognition standard for virtually all industries under generally accepted accounting principles in the United States (U.S. GAAP) including those that previously followed industry-specific guidance. The guidance states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The FASB issued ASU 2015-14 in August 2015 that deferred the effective date of ASU 2014-09 by a year thus the effective date is fiscal years beginning after December 15, 2018. Early adoption is permitted and should be applied retrospectively in the year the ASU is first applied. The Foundation plans to adopt the new ASU at the required implementation date.

In 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). The ASU changes the accounting treatment for operating leases by recognizing a lease asset and lease liability at the present value of the lease payments in the statement of financial position and disclosing key information about leasing arrangements. The ASU is effective for private entities for fiscal years beginning after December 31, 2019. Early adoption is permitted. The ASU should be applied at the beginning of the earliest period presented using a modified retrospective approach.

The Foundation plans to adopt the new ASUs at the required implementation date.

2. INVESTMENTS

At June 30, 2017 and 2016, investments at readily determinable fair values, consisted of the following:

	<u>2017</u>	<u>2016</u>
Equity securities	\$ 20,175,840	\$ 16,574,704
International equity securities	4,168,864	3,399,425
Partnerships/Alternative investments	22,732,632	19,902,319
Corporate bonds and other agencies	4,582,622	10,920,144
Beneficial interest in perpetual trust	<u>3,223,517</u>	<u>3,223,517</u>
Sub-total investments	54,883,475	54,020,109
Cash and cash equivalents held by investment managers	<u>2,874,666</u>	<u>3,211,640</u>
TOTAL INVESTMENTS	<u>\$ 57,758,141</u>	<u>\$ 57,231,749</u>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

2. INVESTMENTS (Continued)

Under the terms of certain agreements for several alternative investments, the Foundation is obligated to remit additional funding periodically as capital calls are exercised.

As of June 30, 2017 and 2016, the Foundation has uncalled commitments of \$1,396,623 and \$1,509,957, respectively.

Alternative investments are comprised of the following at June 30, 2017 and 2016:

<u>Investment Type</u>	<u>Net Asset Value</u>		<u>Uncalled Commitments</u>		<u>Liquidity</u>
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	
Domestic/U.S. Limited Partnerships	\$ 2,191,215	\$ 1,912,775	\$ 1,396,623	\$ 1,509,657	None until dissolution or winding up of partnership.
Domestic/U.S. Limited Partnerships	2,220,104	1,857,864	-	-	100 days notice
Domestic/U.S. Alternative Trusts	4,076,630	3,639,123	-	-	Month end
Domestic/U.S. Limited Partnerships	<u>14,244,683</u>	<u>12,492,557</u>	<u>-</u>	<u>-</u>	Last day of each quarter.
ALTERNATIVE INVESTMENTS	<u>\$ 22,732,632</u>	<u>\$ 19,902,319</u>	<u>\$ 1,396,623</u>	<u>\$ 1,509,657</u>	

Included in the investment balance at June 30, 2017 and 2016 are investments related to certain split-interest agreements in the amounts of \$890,624 and \$887,275, respectively.

The investment portfolio includes \$38,084,134 and \$37,413,618 of permanently restricted endowment investments at June 30, 2017 and 2016, respectively (see Note 17).

The Foundation follows the Uniform Prudent Management Institutional Funds Act (UPMIFA). As such, endowment earnings not yet authorized for spending are shown as temporarily restricted net assets. If, in a given year, there are deficiencies in any endowment fund, unrestricted net assets will cover the deficiencies.

It is the policy of the Foundation to spend on operations 5% of a twelve quarter trailing average of the sum of accumulated investments, including endowment fund investments. This 5% amount is shown in the revenue section of the Statement of Activities and Change in Net Assets. Investment income that exceeds this target and all losses in a given year are considered non-operating items and are included in the capital additions (deductions) section of the Statement of Activities and Change in Net Assets, as "Investment (loss) return, net".

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

2. INVESTMENTS (Continued)

Investment return for the years ended June 30, 2017 and 2016 consisted of the following:

	2017	2016
Interest and dividends	\$ 325,342	\$ 1,045,831
Unrealized gain (loss)	6,343,991	(1,825,422)
Realized gains	294,752	456,770
Total investment (loss) return	6,964,085	(322,821)
Less: Investment distribution for operations	(2,768,964)	(2,768,395)
INVESTMENT GAIN (LOSS) AND DISTRIBUTIONS, NET	\$ 4,195,121	\$ (3,091,216)

3. ACCOUNTS RECEIVABLE

Accounts receivable are stated at their carrying value, which approximates fair value, and are due within one year. The allowance for doubtful accounts is determined based upon an annual review of account balances, including the age of the balance and the historical experience with the customer. Accounts receivable consisted of the following at June 30, 2017 and 2016, respectively:

	2017	2016
Federal and state receivables	\$ 657,295	\$ 762,694
Non-Federal and state receivables	105,232	82,799
Total accounts receivable	762,527	845,493
Less: Allowance for doubtful accounts	(2,852)	(1,909)
NET ACCOUNTS RECEIVABLE	\$ 759,675	\$ 843,584

4. NOTE RECEIVABLE

On July 20, 1998, the Foundation loaned \$135,000 to the Rappahannock Tribe, Inc. (the Tribe). The loan was collateralized by the Tribe's property. The note bears interest at a rate of 7.5% annually, with interest payable monthly. The note was due on July 1, 1999; however, the note has been extended every year and is now due July 1, 2018. Only monthly payments of interest are to be made by the Tribe until maturity. The amounts outstanding at June 30, 2017 and 2016 were \$84,822 and \$87,013, respectively.

5. PLEDGES RECEIVABLE

As of June 30, 2017 and 2016, contributors to the Foundation have made written promises to give totaling \$10,383,756 and \$13,085,147, respectively. Pledges due in more than one year have been recorded at the present value of the estimated cash flows, using a discount rate ranging from 1.8% to 7%. The allowance for doubtful accounts is determined based upon an annual review of account balances, including the age of the balance and the historical experience with the donor.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

5. PLEDGES RECEIVABLE (Continued)

Pledges are due as follows at June 30, 2017 and 2016:

	2017	2016
Less than one year	\$ 2,482,827	\$ 4,492,273
One to five years	2,869,354	3,133,954
Beyond five years	5,031,575	5,458,920
Total pledges	10,383,756	13,085,147
Less: Discount to net present value	(1,108,450)	(1,284,670)
Less: Allowance for doubtful accounts	(102,270)	(123,774)
NET PLEDGES RECEIVABLE	\$ 9,173,036	\$ 11,676,703

6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2017 and 2016:

	2017	2016
Land	\$ 11,747,533	\$ 11,747,533
Building and improvements	26,940,206	26,867,591
Furniture and equipment	5,543,190	3,693,575
Boats	4,058,464	4,003,386
Vehicles	601,955	590,720
Construction in progress	405,365	1,159,406
Art	17,000	17,000
Total property and equipment	49,313,713	48,079,211
Less: Accumulated depreciation and amortization	(18,270,258)	(17,071,657)
NET PROPERTY AND EQUIPMENT	\$ 31,043,455	\$ 31,007,554

The amount of property and equipment (at cost or fair market value at date of donation) that cannot be sold by the Foundation due to donor restrictions is \$8,155,524 at June 30, 2017 and 2016 (see Note 17).

Depreciation and amortization expense for the years ended June 30, 2017 and 2016 totaled \$1,261,187 and \$1,209,626, respectively. Of these amounts, \$823,402 and \$852,080 is included in occupancy expense, and \$437,785 and \$357,546 is included in depreciation and amortization expense in the accompanying Statement of Functional Expenses for the years ended June 30, 2017 and 2016, respectively.

7. LOAN PAYABLE

The Chesapeake Bay Foundation's Brock Environmental Center is a 10,200 square foot facility located at Pleasure House Point in Virginia Beach, Virginia. It sits on land once slated for heavy development that is now saved in perpetuity.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

7. LOAN PAYABLE (Continued)

The Brock Environmental Center provides a collaborative workspace for all of the Foundation's Virginia Beach program staff, the local Lynnhaven River NOW environmental group, a partner group of the Foundation, and the City of Virginia Beach Parks and Recreation.

The Brock Environmental Center is also a venue for expanded environmental education programs for decision makers, students, teachers and volunteers, serves as a lasting demonstration site for restoration projects, and provides meeting space for local nonprofit groups.

The Brock Environmental Center is one of the most sustainable buildings in the world. The facility earned both the U.S. Green Building Council's LEED Platinum Certification and the International Living Building Institute's Living Building Challenge Certification.

On October 1, 2013, the Foundation obtained a variable rate taxable loan in the amount of \$8,300,000 from Capital One in connection with the development of the Brock Environmental Center (the "Taxable Loan"). The Taxable Loan is unsecured, and is structured as a "draw down facility" and payments are interest only through maturity. The Foundation does not expect any additional draw downs on the loan. The entire unpaid balance, together with all accrued and unpaid interest, shall be due and payable in full on the maturity date of October 1, 2020. The total amount of the loan outstanding as of June 30, 2017 and 2016 was \$1,417,571 and \$2,408,828, respectively.

Total interest of \$14,937 was capitalized and included in the buildings and improvements account for the year ending June 30, 2015. Additionally, financing costs totaling \$67,560, related to obtaining the Taxable Loan, were capitalized and are being amortized over the life of the Taxable Loan. At June 30, 2017 and 2016, accumulated amortization for the Taxable Loan financing costs totaled \$35,389 and \$25,737, respectively.

Additionally, the agreements for the loan payable and bonds payable (discussed in Note 8) contain various covenants, which among other things, require the Foundation to maintain certain financial ratios and submit various financial reports throughout their fiscal year.

Interest expense for the years ended June 30, 2017 and 2016 was \$47,850 and \$69,714, respectively, which is included in occupancy and utilities expense within the Statement of Functional Expenses.

As of June 30, 2017 and 2016, the outstanding balance of the loan payable is as follows:

	<u>2017</u>	<u>2016</u>
Loan principal payable	\$ 1,449,742	\$ 2,449,742
Less: Deferred financing costs, net of accumulated depreciation of \$35,389 and \$25,737, respectively	<u>(32,171)</u>	<u>(40,914)</u>
NET LOAN PAYABLE	<u>\$ 1,417,571</u>	<u>\$ 2,408,828</u>

8. BONDS PAYABLE

In December 2000, the Foundation moved into its U.S. Green Building Council LEED Platinum headquarters, a facility named the Philip Merrill Environmental Center (Merrill Center), which is widely recognized as one of the most environmentally innovative buildings in the world.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

8. BONDS PAYABLE (Continued)

The facility includes a two story, 30,000 square foot "green" office building and common meeting centers for internal and external groups. Since moving into the Merrill Center, much of the site has been and continues to be restored with native plants.

During fiscal year 2014, the "Variable Rate Economic Development Revenue Bonds, Series 1998" which were used to finance the acquisition, construction and equipping a portion of the Merrill Center, were refinanced with the related bond sinking fund extinguished and capitalized costs fully amortized. As described further below, no amount of the 1998 Bonds was outstanding as of June 30, 2014.

On October 1, 2013, the Maryland Economic Development Corporation (MEDCO) issued an Economic Development Refunding Revenue Bond, The Chesapeake Bay Foundation Project, 2013 Series (the "2013 Series Bonds") in the amount of \$6,195,000 for the benefit of the Foundation. Proceeds of the 2013 Series Bonds were used to refinance MEDCO's outstanding 1998 Series Bonds, noted above.

The 2013 Series Bonds were purchased by Capital One Bank, N.A. ("Capital One"). Principal and interest on the 2013 Series Bonds are due monthly based on a mortgage style amortization structure. The final maturity date of the Series 2013 Bonds is October 1, 2023. Financing costs related to the issuance of the 2013 Series Bonds in the amount of \$87,420, were capitalized and are being amortized over the life of the bonds. At June 30, 2017 and 2016, accumulated amortization for the bond financing costs totaled \$32,054 and \$23,312, respectively.

To mitigate the effect of fluctuations in interest rates, the Foundation has hedged these bonds using the interest rate swap agreement described in Note 9. The bond agreements, among other provisions, require the Foundation to meet certain financial ratio tests. For the years ended June 30, 2017 and 2016, the Foundation was in compliance with all bond covenants.

As of June 30, 2017 and 2016, the outstanding balance of the bond payable is as follows:

	2017	2016
Bond principal payable	\$ 4,299,385	\$ 4,854,120
Less: Deferred financing costs, less accumulated amortization of \$32,054 and \$23,312, respectively	(55,366)	(65,017)
NET BONDS PAYABLE	\$ 4,244,019	\$ 4,789,103

Principal payments are due as follows:

Year Ending June 30,

2018	\$ 585,406
2019	616,824
2020	652,423
2021	687,925
2022	726,002
Thereafter	1,030,805
BONDS PAYABLE	\$ 4,299,385

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

8. BONDS PAYABLE (Continued)

The Foundation incurred interest expense on the bonds totaling \$247,144 and \$275,798 for the years ended June 30, 2017 and 2016, respectively, which is included in occupancy and utilities expense within the Statement of Functional Expenses.

9. INTEREST RATE SWAP

The bonds discussed in Note 8 include interest payments based on the Securities Industry and Financial Markets Association ("SIFMA") Index, formerly the Bond Market Association (BMA). As a means to reduce its exposure to volatility in the variable rate index, the Foundation entered into certain interest rate swap agreements. The intention of the swap agreement is to synthetically fix the interest rate on the bonds.

The Foundation had an interest rate swap agreement (the "Wells Fargo Swap"), which was terminated on September 27, 2013 in connection with the issuance of the 2013 Series Bonds. The market value of the Wells Fargo Swap, at the time of termination, was embedded in the new Swap provided by Capital One Bank, N.A. (the "Capital One Swap"). Under the Capital One Swap, the Foundation pays a fixed rate of 4.52% and receives a floating rate equal to 78% of 1-Month LIBOR. The Capital One Swap hedges 100% of the outstanding amount of the 2013 Series Bonds and provides the Foundation with a synthetic fixed rate cost of capital through the maturity of the 2013 Series Bonds on October 1, 2023.

For the years ended June 30, 2017 and 2016, the outstanding notional amount of the Capital One Swap was \$4,299,385 and \$4,854,120, respectively. As of June 30, 2017 and 2016, the Capital One Swap had a negative fair value of \$438,167 and \$721,368, respectively, which is reflected as a liability in the financial statements.

The swaps expose the Foundation to basis risk should the actual rate on the Foundation's bonds exceed the LIBOR Index for the years ended June 30, 2017 and 2016. Since the Foundation's bonds are based upon the LIBOR Index, there is relatively little basis risk. Should the Foundation terminate the Capital One Swap prior to maturity, the Foundation will either receive or pay a termination payment. This payment is equal to the fair value of the Capital One Swap at the time it is terminated.

10. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at June 30, 2017 and 2016:

	2017	2016
Program Restricted:		
Environmental Education	\$ 473,437	\$ 541,564
Environmental Protection and Restoration	6,944,267	6,881,215
Property and Equipment	764,871	868,921
Other	17,201	17,201
Total program restricted	8,199,776	8,308,901
Time Restricted	11,462,164	8,924,826
TEMPORARILY RESTRICTED NET ASSETS	\$ 19,661,940	\$ 17,233,727

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

10. TEMPORARILY RESTRICTED NET ASSETS (Continued)

The Foundation is the recipient of several charitable remainder unitrusts that are administered by third parties. Under the terms of these trusts, payments of income are made from the trusts to the donors or other specified parties over the terms of the trusts. Upon the termination of the trusts, the remaining net assets will be transferred to the Foundation for its unrestricted use.

Accumulated investment earnings from permanently restricted endowed funds included within temporarily restricted net assets as of June 30, 2017 and 2016 are as follows:

	2017	2016
With purpose restrictions	\$ 5,060,811	\$ 3,777,793
Time restriction	2,435,110	1,123,962
ACCUMULATED ENDOWMENT EARNINGS INCLUDED IN TEMPORARILY RESTRICTED NET ASSETS	\$ 7,495,921	\$ 4,901,755

Temporarily restricted net assets released from donor restrictions by incurring expenses, which satisfied the restricted purposes specified by the donors or the passage of time are as follows:

	2017	2016
Donor Restrictions:		
Environmental Education	\$ 994,159	\$ 1,652,024
Environmental Protection and Restoration	5,907,122	8,114,673
Property and Equipment	366,857	265,655
Other	397,458	48,748
Total donor restrictions	7,665,596	10,081,100
Time Restrictions:		
Time Restricted	2,309,900	2,233,893
Time restricted (death of donors)	29,363	-
Total time restrictions	2,339,263	2,233,893
NET ASSETS RELEASED FROM RESTRICTIONS	\$ 10,004,859	\$ 12,314,993

11. LEASE COMMITMENT

The Foundation leases office space, equipment, and distribution facilities under noncancellable leases expiring at various dates.

Certain lease agreements call for escalation of rental payments based upon increases in operating costs of the lessor and increases in consumer price indices. Additionally, some of the leases include renewal options ranging from three months to three years.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

11. LEASE COMMITMENT (Continued)

The minimum rental payments under these noncancellable leases for future fiscal years are as follows:

<u>Year Ending June 30,</u>	
2018	\$ 252,917
2019	189,213
2020	79,513
2021	56,400
2022	55,793
Thereafter	<u>9,359</u>
	<u><u>\$ 643,195</u></u>

Rent expense for the years ended June 30, 2017 and 2016 totaled \$250,727 and \$248,267, respectively. Rent expense is included in occupancy and utilities in the Statement of Functional Expenses.

12. DEFINED CONTRIBUTION RETIREMENT BENEFIT PLAN

Retirement benefits are available for substantially all regular, full-time Foundation personnel, through direct payments by the Foundation to the Plan administrators. For these employees, the Foundation matches the employee's voluntary contribution up to four percent. For the years ended June 30, 2017 and 2016, the Foundation made contributions in the amounts of \$403,463 and \$376,026, respectively.

13. RELATED PARTY

For the years ended June 30, 2017 and 2016, the Foundation received gross contributions and grants in the amounts of \$2,650,369 and \$4,094,833, respectively, from Trustees and Executive Management. Net amounts due under pledges receivable from related parties totaled \$2,432,177 and \$2,663,790 as of June 30, 2017 and 2016, respectively.

14. CONTINGENCIES

The Foundation receives grants from various agencies of the United States Government. For the fiscal year ended June 30, 2017, such grants are subject to audit under the provisions of *Title 2 U.S. Code of Federal Regulations (CFR) Part 200 Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*. The ultimate determination of amounts received under the United States Government grants is based upon the allowance of costs reported to and accepted by the United States Government as a result of the audits. Audits in accordance with the applicable provisions have been completed for all required fiscal years through 2017. Until such audits have been accepted by the United States Government, there exists a contingency to refund any amount received in excess of allowable costs. Management is of the opinion that no material liability will result from such audits.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

14. CONTINGENCIES (Continued)

Various lawsuits and other contingent liabilities arise in the ordinary course of the Foundation's activities. While the final outcome of these legal actions cannot be determined at this time, management is of the opinion that the ultimate liability, if any, from the final resolution of these matters will not have a material effect on the Foundation's financial statements.

15. DONATED GOODS, SERVICES AND PROPERTY

During the years ended June 30, 2017 and 2016, the Foundation was the beneficiary of donated goods and services, which allow the Foundation to provide greater resources toward various programs. To properly reflect total program expenses, donations totaling \$1,255,568 and \$1,191,947 have been included in revenue and expense for the years ended June 30, 2017 and 2016, respectively, which included \$1,150,000 and \$1,049,500 of in-kind public service announcements for the years ended June 30, 2017 and 2016, respectively.

16. FAIR VALUE MEASUREMENT

In accordance with FASB ASC 820, *Fair Value Measurement*, the Foundation has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Investments recorded in the Statement of Financial Position are categorized based on the inputs to valuation techniques as follows:

Level 1. These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Foundation has the ability to access.

Level 2. These are investments where values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, or model-based valuation techniques that utilize inputs that are observable either directly or indirectly for substantially the full-term of the investments.

Level 3. These are investments where inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Following is a description of the valuation methodology used for investments measured at fair value. There have been no changes in the methodologies or classifications used at June 30, 2017.

! *Equity/International Equity* - Valued at the closing price reported on the active market in which the individual securities are traded.

! *Partnerships/Alternative investments* - these instruments do not have a readily determinable fair value. Fair value for these instruments is measured using the net asset value per share practical expedient, in accordance with ASU 2015-07.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

16. FAIR VALUE MEASUREMENT (Continued)

- ! *Corporate bonds and other agencies* - Fair value is based upon current yields available on comparable securities of issuers with similar ratings, the security's terms and conditions, and interest rate and credit risk.
- ! *Beneficial interest in perpetual trust* - Valued at the present value of discounted cash flows of the trust investment value into perpetuity.
- ! *Cash and cash equivalents held by investment managers* - Fair value is equal to the reported net asset value of the fund.
- ! *Interest rate swap obligations* - Fair value is derived from quotes from a dealer or broker, where available. Models used in valuing such agreements consider the contractual terms of and specific risks inherent in the instrument, and inputs used typically include yield curve, instrument volatility, prepayment rates and assumptions concerning nonperformance risk.

For the year ended June 30, 2017, there were no transfers between levels. Transfers between levels are recorded at the end of the reporting period, if applicable.

The tables below summarizes, by level within the fair value hierarchy, the Foundation's investments as of June 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total June 30, 2017</u>
Asset Class:				
Equity securities	\$ 20,175,840	\$ -	\$ -	\$ 20,175,840
International equity securities	4,168,864	-	-	4,168,864
Corporate bonds and other agencies	4,582,622	-	-	4,582,622
Beneficial interest in perpetual trust	-	3,223,517	-	3,223,517
Cash and cash equivalents held by investment managers	2,874,666	-	-	2,874,666
Investments Measured at Net Asset Value:				
Partnerships/Alternative investments	<u>-</u>	<u>-</u>	<u>-</u>	<u>22,732,632</u>
Total Investments	<u>\$ 31,801,992</u>	<u>\$ 3,223,517</u>	<u>\$ -</u>	<u>\$ 57,758,141</u>
Liability:				
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ 438,167</u>	<u>\$ -</u>	<u>\$ 438,167</u>

Investments measured at net asset value: Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation the fair value hierarchy to the amounts presented in the Statement of Financial Position.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

16. FAIR VALUE MEASUREMENT (Continued)

For the year ended June 30, 2016, there were no transfers between levels. Transfers between levels are recorded at the end of the reporting period, if applicable.

The tables below summarizes, by level within the fair value hierarchy, the Foundation's investments as of June 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total June 30, 2016</u>
Asset Class:				
Equity securities	\$ 16,574,704	\$ -	\$ -	\$ 16,574,704
International equity securities	3,399,425	-	-	3,399,425
Corporate bonds and other agencies	10,920,144	-	-	10,920,144
Beneficial interest in perpetual trust	-	3,223,517	-	3,223,517
Cash and cash equivalents held by investment managers	3,211,640	-	-	3,211,640
Investments Measured at Net Asset Value:				
Partnerships/Alternative investments	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,902,319</u>
Total Investments	<u>\$ 34,105,913</u>	<u>\$ 3,223,517</u>	<u>\$ -</u>	<u>\$ 57,231,749</u>
Liability:				
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ 721,368</u>	<u>\$ -</u>	<u>\$ 721,368</u>

Investments measured at net asset value: Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation the fair value hierarchy to the amounts presented in the Statement of Financial Position.

17. ENDOWMENT

The Foundation's endowment consists of several individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as an endowment. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on existence or absence of donor imposed restrictions. The Board of Trustees has interpreted UPMIFA 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 Foundation 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.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

17. ENDOWMENT (Continued)

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. (See Note 10, total endowments funds classified as temporarily restricted net assets.)

In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- ! The duration and preservation of the fund;
- ! The purpose of the donor-restricted endowment fund;
- ! General economic conditions and the possible effect of inflation and deflation;
- ! The expected total return from income and the appreciation of investments; and
- ! The investment policies of the organization.

Permanently restricted net assets are invested in-perpetuity, the income of which is restricted to the following:

	<u>2017</u>	<u>2016</u>
Environmental education	\$ 10,429,108	\$ 10,267,588
Environmental protection and restoration	13,514,767	13,514,767
Property and equipment	8,155,524	8,155,524
General operating	<u>14,173,476</u>	<u>14,169,120</u>
PERMANENTLY RESTRICTED NET ASSETS	<u>\$ 46,272,875</u>	<u>\$ 46,106,999</u>

Permanently restricted net assets consists of the following:

	<u>2017</u>	<u>2016</u>
Investments	\$ 38,084,134	\$ 37,413,618
Property and equipment	8,155,524	8,155,524
Pledge receivables, net of discount	<u>33,217</u>	<u>537,857</u>
PERMANENTLY RESTRICTED NET ASSETS	<u>\$ 46,272,875</u>	<u>\$ 46,106,999</u>

Endowment net asset composition by type of fund as of June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-Restricted Endowment Funds	\$ (632,245)	\$ 7,495,921	\$ 46,272,875	\$ 53,136,551
Board-Designated Endowment Funds	<u>913,277</u>	<u>-</u>	<u>-</u>	<u>913,277</u>
TOTAL FUNDS	<u>\$ 281,032</u>	<u>\$ 7,495,921</u>	<u>\$ 46,272,875</u>	<u>\$ 54,049,828</u>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

17. ENDOWMENT (Continued)

Changes in endowment net assets for the year ended June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (369,143)	\$ 4,901,755	\$ 46,106,999	\$ 50,639,611
Interest and dividends	3,409	382,006	-	385,415
Net appreciation of investments	<u>112,738</u>	<u>4,966,682</u>	<u>131,712</u>	<u>5,211,132</u>
Total investment return	<u>116,147</u>	<u>5,348,688</u>	<u>131,712</u>	<u>5,596,547</u>
Contributions	-	-	34,164	34,164
Appropriation of endowment assets for expenditure	577,088	(577,088)	-	-
Other changes:				
Transfer of net assets	<u>(43,060)</u>	<u>(2,177,434)</u>	<u>-</u>	<u>(2,220,494)</u>
ENDOWMENT NET ASSETS, END OF YEAR	<u>\$ 281,032</u>	<u>\$ 7,495,921</u>	<u>\$ 46,272,875</u>	<u>\$ 54,049,828</u>

Endowment net asset composition by type of fund as of June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-Restricted Endowment Funds	\$ (1,209,333)	\$ 4,901,755	\$ 46,106,999	\$ 49,799,421
Board-Designated Endowment Funds	<u>840,190</u>	<u>-</u>	<u>-</u>	<u>840,190</u>
TOTAL FUNDS	<u>\$ (369,143)</u>	<u>\$ 4,901,755</u>	<u>\$ 46,106,999</u>	<u>\$ 50,639,611</u>

Changes in endowment net assets for the year ended June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 217,327	\$ 6,380,315	\$ 44,638,965	\$ 51,236,607
Interest and dividends	15,266	917,237	26	932,529
Net appreciation of investments	<u>(22,092)</u>	<u>(1,033,361)</u>	<u>13</u>	<u>(1,055,440)</u>
Total investment return	<u>(6,826)</u>	<u>(116,124)</u>	<u>39</u>	<u>(122,911)</u>
Contributions	15,000	-	1,326,720	1,341,720
Appropriation of endowment assets for expenditure	(42,576)	(2,178,284)	-	(2,220,860)
Other changes:				
Transfer of net assets	<u>(552,068)</u>	<u>815,848</u>	<u>141,275</u>	<u>405,055</u>
ENDOWMENT NET ASSETS, END OF YEAR	<u>\$ (369,143)</u>	<u>\$ 4,901,755</u>	<u>\$ 46,106,999</u>	<u>\$ 50,639,611</u>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

17. ENDOWMENT (Continued)

Funds with Deficiencies -

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Foundation to retain into perpetuity. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$632,245 and \$1,209,333 as of June 30, 2017 and 2016, respectively. These deficiencies resulted from unfavorable market fluctuations occurring after the investment of permanently restricted contributions and the appropriation for certain programs that were deemed prudent by the Board of Trustees.

Return Objectives and Risk Parameters -

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Foundation must hold in-perpetuity or for a donor-specified period(s). Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed a blended index of the Standard & Poor's 500 Index and the Barclays Aggregate Bond Index while assuming a moderate level of investment risk. The Foundation expects its endowment funds, over time, to provide an average rate of return of approximately 8% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives -

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based and partnerships/alternative investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy -

The Foundation has a policy of appropriating for distribution each year 5% of a twelve quarter trailing average of the sum of accumulated investments for each fund. In establishing this policy, the Foundation considered the long-term expected return on its endowment. Accordingly, over the long-term, the Foundation expects the current spending policy to allow its endowment to grow. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in-perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

18. SUBSEQUENT EVENTS

In preparing these financial statements, the Foundation has evaluated events and transactions for potential recognition or disclosure through December 14, 2017, the date the financial statements were issued.

SUPPLEMENTAL INFORMATION

CHESAPEAKE BAY FOUNDATION, INC.**SUMMARY OF CONSERVATION AND SCENIC EASEMENTS
FOR INFORMATION PURPOSES ONLY (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017**

The Chesapeake Bay Foundation, Inc. (the Foundation) holds conservation and scenic easements on various properties in the Chesapeake Bay region that are designed to prohibit the property owner, his successor, heirs, or assignees from developing or altering the property in any way inconsistent with the easement. The Foundation has responsibility for enforcing the specific provisions of each easement, which are primarily obtained by donation. The following is a description of easements held at June 30, 2017.

Maryland

- Approximately 45 acres along the Tavern Creek in Kent County, Maryland
- Approximately 70 acres along the Southeast Creek in Queen Anne's County, Maryland
- Approximately 209 acres along the Pocomoke River in Somerset County, Maryland

Virginia

- Approximately 1 acre along the Smarts Creek/Potomac River in Westmoreland County, Virginia
- Approximately 2 acres along the Pamunkey River in King William County, Virginia
- Approximately 20 acres along Middle River in Augusta County, Virginia
- Approximately 20 acres along Brush Creek in Frederick County, Virginia
- Approximately 32 acres along the Dragon Run in Middlesex County, Virginia
- Approximately 37 acres along the Jordan River in Rappahannock County, Virginia
- Approximately 39 acres along the Totuskey Creek in Richmond County, Virginia
- Approximately 72 acres near Piscataway Creek in King and Queen and Essex Counties, Virginia
- Approximately 72 acres along the Chesapeake Bay in Northumberland County, Virginia
- Approximately 94 acres along Barnes Creek in Northumberland County, Virginia
- Approximately 118 acres along Mountain Run in Orange County, Virginia
- Approximately 150 acres along Garden Creek and the Chesapeake Bay in Mathews County, Virginia