

FINANCIAL STATEMENTS

CHESAPEAKE BAY FOUNDATION, INC.

**FOR THE YEAR ENDED JUNE 30, 2011
WITH SUMMARIZED FINANCIAL
INFORMATION FOR 2010**

CHESAPEAKE BAY FOUNDATION, INC.

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GELMAN, ROSENBERG & FREEDMAN
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statement of financial position of the Chesapeake Bay Foundation, Inc. (the Foundation) as of June 30, 2011, and the related statements of activities and change in net assets, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Foundation's financial statements for the year ended June 30, 2010 and, in our report dated November 15, 2010, we expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2011, and its change in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2011 on our consideration of the Foundation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

November 14, 2011

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CHESAPEAKE BAY FOUNDATION, INC.
STATEMENT OF FINANCIAL POSITION
AS OF JUNE 30, 2011
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2010

ASSETS

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 5,879,623	\$ 7,180,772
Investments (Notes 2 and 16)	45,137,679	40,449,794
Cash held in bond sinking fund (Note 8)	331,201	307,232
Accounts receivable, less allowance for doubtful accounts of \$16,619 and \$2,856 for 2011 and 2010, respectively (Notes 3 and 13)	1,520,910	6,270,573
Note receivable (Note 4)	103,000	103,000
Pledges receivable, net of allowance for doubtful accounts of \$95,090 and \$105,212 for 2011 and 2010, respectively (Notes 5 and 13)	6,718,373	7,482,323
Other assets	401,161	428,668
Deferred financing cost, net of accumulated amortization of \$67,750 and \$62,330 for 2011 and 2010, respectively (Note 8)	67,751	73,171
Property and equipment, net of accumulated depreciation and amortization of \$12,803,230 and \$12,282,039 for 2011 and 2010, respectively (Note 6)	<u>20,220,335</u>	<u>20,607,130</u>
TOTAL ASSETS	<u>\$ 80,380,033</u>	<u>\$ 82,902,663</u>

LIABILITIES AND NET ASSETS

LIABILITIES

Note payable (Note 7)	\$ 609,051	\$ 648,143
Bonds payable (Note 8)	7,030,000	7,420,000
Accounts payable and accrued expenses	2,090,908	7,187,758
Deferred income	157,838	116,027
Liability under split interest agreements	878,468	878,034
Interest rate swap obligation (Notes 9 and 16)	<u>905,112</u>	<u>985,756</u>
Total liabilities	<u>11,671,377</u>	<u>17,235,718</u>

NET ASSETS

Unrestricted	20,515,896	18,827,993
Temporarily restricted (Note 10)	9,109,509	8,166,272
Permanently restricted (Note 17)	<u>39,083,251</u>	<u>38,672,680</u>
Total net assets	<u>68,708,656</u>	<u>65,666,945</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 80,380,033</u>	<u>\$ 82,902,663</u>

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

**STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2011
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2010**

	2011			2010	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
REVENUE					
Membership contributions	\$ 5,032,299	\$ -	\$ -	\$ 5,032,299	\$ 4,920,926
Grants and gifts (Note 13)	13,066,841	3,895,988	-	16,962,829	22,728,257
Education contracts and tuition	980,780	-	-	980,780	1,031,464
Investment income (Note 2)	538,218	1,445,328	-	1,983,546	2,114,249
Donated goods and services (Note 15)	1,817,972	-	-	1,817,972	410,613
Other	511,750	-	-	511,750	529,676
Net assets released from donor restrictions (Note 10)	<u>5,804,389</u>	<u>(5,804,389)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total revenue	<u>27,752,249</u>	<u>(463,073)</u>	<u>-</u>	<u>27,289,176</u>	<u>31,735,185</u>
EXPENSES					
Program Services:					
Environmental Education	6,812,969	-	-	6,812,969	5,930,819
Environmental Protection and Restoration	14,069,495	-	-	14,069,495	18,957,906
Communications	<u>3,174,121</u>	<u>-</u>	<u>-</u>	<u>3,174,121</u>	<u>2,489,086</u>
Total program services	<u>24,056,585</u>	<u>-</u>	<u>-</u>	<u>24,056,585</u>	<u>27,377,811</u>
Support Services:					
General and Administrative	1,776,609	-	-	1,776,609	1,651,016
Fundraising	<u>3,227,705</u>	<u>-</u>	<u>-</u>	<u>3,227,705</u>	<u>3,021,604</u>
Total support services	<u>5,004,314</u>	<u>-</u>	<u>-</u>	<u>5,004,314</u>	<u>4,672,620</u>
Total expenses	<u>29,060,899</u>	<u>-</u>	<u>-</u>	<u>29,060,899</u>	<u>32,050,431</u>
Change in net assets before capital additions (deductions)	<u>(1,308,650)</u>	<u>(463,073)</u>	<u>-</u>	<u>(1,771,723)</u>	<u>(315,246)</u>
CAPITAL ADDITIONS (DEDUCTIONS)					
Investment return, net (Note 2)	3,201,945	1,406,310	159,993	4,768,248	1,642,234
Grants and gifts (Note 13)	-	-	11,106	11,106	31,254
Donated property (Note 15)	8,000	-	-	8,000	10,650
Gain (loss) on sale/transfer of property	(54,564)	-	-	(54,564)	9,500
Unrealized gain (loss) on interest rate swap (Note 9)	80,644	-	-	80,644	(263,995)
Transfer of net assets (Note 17)	<u>(239,472)</u>	<u>-</u>	<u>239,472</u>	<u>-</u>	<u>-</u>
Total capital additions (deductions)	<u>2,996,553</u>	<u>1,406,310</u>	<u>410,571</u>	<u>4,813,434</u>	<u>1,429,643</u>
Change in net assets	1,687,903	943,237	410,571	3,041,711	1,114,397
Net assets at beginning of year	<u>18,827,993</u>	<u>8,166,272</u>	<u>38,672,680</u>	<u>65,666,945</u>	<u>64,552,548</u>
NET ASSETS AT END OF YEAR	\$ <u>20,515,896</u>	\$ <u>9,109,509</u>	\$ <u>39,083,251</u>	\$ <u>68,708,656</u>	\$ <u>65,666,945</u>

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2011
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2010

	2011			
	Program Services			
	Environmental Education	Environmental Protection and Restoration	Communications	Total Program Services
Salaries	\$ 2,280,614	\$ 3,498,215	\$ 985,238	\$ 6,764,067
Fringe benefits (Note 12)	867,427	1,292,065	377,672	2,537,164
Supplies	236,588	134,574	38,650	409,812
Restoration supplies	-	249,204	-	249,204
Telephone	48,950	94,757	11,864	155,571
Postage and shipping	129,285	271,242	131,614	532,141
Occupancy and utilities (Notes 9 and 11)	585,964	661,819	134,085	1,381,868
Equipment rental, leasing, repairs and maintenance	157,202	87,440	21,228	265,870
Printing and publications	144,079	325,511	251,556	721,146
Dues and subscriptions	1,314	36,336	6,212	43,862
Travel	185,511	142,768	19,315	347,594
Meetings and seminars	44,746	116,107	18,146	178,999
Outside services	19,323	47,661	100,827	167,811
Boat charter	38,715	9,910	138	48,763
Professional fees	239,284	1,245,912	318,692	1,803,888
Restoration fees	-	738,279	-	738,279
Personnel recruitment	-	1,716	-	1,716
Miscellaneous	4,740	18,793	1,158	24,691
Mailing preparation	41,619	87,488	17,439	146,546
Honorariums/stipends	-	699	-	699
Insurance	153,603	90,553	10,952	255,108
List rentals	58,271	122,492	24,416	205,179
Depreciation and amortization - other	177,331	76,427	5,954	259,712
Subcontracts	583,086	3,577,254	-	4,160,340
Donated goods and services (Note 15)	563,184	612,750	593,492	1,769,426
Sub-total	6,560,836	13,539,972	3,068,648	23,169,456
Allocation of management and general	252,133	529,523	105,473	887,129
TOTAL	\$ 6,812,969	\$ 14,069,495	\$ 3,174,121	\$ 24,056,585

See accompanying notes to financial statements.

					2010
Support Services					
General and Administrative	Fundraising	Total Support Services	Total Expenses	Total Expenses	
\$ 1,392,261	\$ 1,135,865	\$ 2,528,126	\$ 9,292,193	\$ 9,040,956	
534,515	436,673	971,188	3,508,352	3,364,589	
56,464	70,872	127,336	537,148	518,996	
-	-	-	249,204	317,336	
6,990	10,800	17,790	173,361	161,133	
4,348	275,175	279,523	811,664	637,508	
171,071	132,649	303,720	1,685,588	1,589,790	
46,932	34,501	81,433	347,303	379,555	
14,998	304,467	319,465	1,040,611	806,949	
4,942	3,293	8,235	52,097	71,368	
26,061	15,184	41,245	388,839	354,060	
60,964	66,236	127,200	306,199	228,795	
53,766	69,295	123,061	290,872	203,519	
-	-	-	48,763	43,903	
296,861	263,589	560,450	2,364,338	2,201,795	
-	-	-	738,279	973,049	
10,871	-	10,871	12,587	6,463	
33,722	9,238	42,960	67,651	82,917	
-	98,003	98,003	244,549	229,966	
-	-	-	699	303	
31,770	22,034	53,804	308,912	296,650	
-	98,694	98,694	303,873	230,318	
46,528	3,265	49,793	309,505	319,067	
-	-	-	4,160,340	9,580,833	
750	47,796	48,546	1,817,972	410,613	
2,793,814	3,097,629	5,891,443	29,060,899	32,050,431	
(1,017,205)	130,076	(887,129)	-	-	
\$ 1,776,609	\$ 3,227,705	\$ 5,004,314	\$ 29,060,899	\$ 32,050,431	

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2011
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 3,041,711	\$ 1,114,397
Adjustments to reconcile change in net assets to net cash (used) provided by operating activities:		
Depreciation and amortization	852,844	833,265
Unrealized (gain) loss on interest rate swap	(80,644)	263,995
Loss (gain) on sale of property	54,564	(9,500)
Donated property	(8,000)	(10,650)
Capital additions - permanently restricted contributions	(11,106)	(31,254)
Change in the discount of long-term pledges receivable	(247,804)	(142,635)
Change in allowance for doubtful accounts	3,641	(27,660)
Unrealized gain on investments	(6,244,469)	(4,305,501)
Realized (gain) loss on investments	(49,767)	1,056,653
(Increase) decrease in:		
Accounts receivable	4,735,900	(5,670,553)
Pledges receivable	1,021,876	2,621,451
Other assets	27,507	(141,227)
Increase (decrease) in:		
Accounts payable and accrued expenses	(5,096,850)	5,555,662
Deferred income	41,811	(71,923)
Liability under split interest agreements	<u>434</u>	<u>(49,144)</u>
Net cash (used) provided by operating activities	<u>(1,958,352)</u>	<u>985,376</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from sale of investments	1,606,351	1,595,412
Purchases of property	(542,263)	(428,362)
Proceeds from sale of property	<u>35,070</u>	<u>9,500</u>
Net cash provided by investing activities	<u>1,099,158</u>	<u>1,176,550</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital additions - permanently restricted contributions	11,106	31,254
Increase in cash held for bond sinking fund	(23,969)	(14,988)
Payments on bonds payable	(390,000)	(375,000)
Payments on note payable	<u>(39,092)</u>	<u>(36,982)</u>
Net cash used by financing activities	<u>(441,955)</u>	<u>(395,716)</u>

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2011
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2010

	<u>2011</u>	<u>2010</u>
Net (decrease) increase in cash and cash equivalents	\$ (1,301,149)	\$ 1,766,210
Cash and cash equivalents at beginning of year	<u>7,180,772</u>	<u>5,414,562</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 5,879,623</u>	<u>\$ 7,180,772</u>
 SUPPLEMENTAL INFORMATION:		
Interest Paid	<u>\$ 454,482</u>	<u>\$ 439,108</u>
Taxes Paid	<u>\$ 22,144</u>	<u>\$ 46,570</u>

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

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 lands 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, 2010, 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 twelve months or less to be cash equivalents, excluding cash and cash equivalents held by investment managers in the amounts of \$4,139,542 and \$1,560,259, for the years ended June 30, 2011 and 2010, respectively.

At times during the year, the Foundation maintains cash balances at financial institutions in excess of the Federal Deposit Insurance Corporation (FDIC) 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, real estate investment trusts, money market funds held for investment purposes, limited partnerships, and a non-domestic professional fund. 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 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 relate 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.

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

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

Investments (continued) -

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.

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 and pledges receivable approximate fair value. 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 bond issuance costs and other costs related to the acquisition of the Bay Ridge Facility for use as the Foundation's Headquarters (Note 8). Deferred financing costs are being amortized over the life of the bonds.

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

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.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

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

Split interest agreements (continued) -

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, 2011 and 2010, liabilities under split interest agreements totaled \$878,468 and \$878,034, 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.

Contributions and grants -

Contributions and grants are recorded as revenue in the year notification is received from the donor. 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. Contributions and grants received in excess of expenses incurred are shown as temporarily restricted net assets in the accompanying financial statements.

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 reports unrelated business income associated with two of its investments. Accordingly, the Foundation has recorded income tax expense in the amount of \$26,027 and \$44,159 for the years ended June 30, 2011 and 2010, respectively.

An unrelated business income tax in the amount of \$10,313 and \$6,430 was recorded as a liability and included in accounts payable in the Statement of Financial Position as of June 30, 2011 and 2010, respectively.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

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

Income taxes (continued) -

In June 2006, the Financial Accounting Standards Board (FASB) released FASB ASC 740-10, *Income Taxes*, that provides guidance for reporting uncertainty in income taxes. For the years ended June 30, 2011 and 2010, the Foundation has documented its consideration of FASB ASC 740-10 and determined that no material uncertain tax positions qualify for either recognition or disclosure in the financial statements. The Federal Form 990, *Return of Organization Exempt from Income Tax*, is subject to examination by the Internal Revenue Service, generally for three years after it is filed.

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 measurements -

The Foundation adopted the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*. 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. Accordingly, certain costs have been allocated among the programs and support services benefited.

Joint costs -

For fiscal years 2011 and 2010, the Foundation incurred joint costs of \$2,665,993 and \$2,232,286, respectively, for educational materials, membership and support services. These costs were allocated as follows:

	<u>2011</u>	<u>2010</u>
Environmental Education	\$ 498,667	\$ 421,732
Environmental Protection and Restoration	1,048,254	819,324
Communications	208,948	178,916
Fundraising	<u>910,124</u>	<u>812,314</u>
TOTAL JOINT COSTS INCURRED	<u>\$ 2,665,993</u>	<u>\$ 2,232,286</u>

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

2. INVESTMENTS

At June 30, 2011 and 2010, investments at readily determinable fair values consisted of the following:

	<u>2011</u>	<u>2010</u>
Equity securities	\$ 20,075,876	\$ 13,777,804
Partnerships/Alternative investments	17,327,143	14,683,916
Corporate bonds and other agencies	631,387	7,465,737
Beneficial interest in perpetual trust	2,924,350	2,924,350
U.S. Government obligations	<u>39,381</u>	<u>37,728</u>
Sub-total investments	40,998,137	38,889,535
Cash and cash equivalents held by investment managers	<u>4,139,542</u>	<u>1,560,259</u>
TOTAL INVESTMENTS	<u>\$ 45,137,679</u>	<u>\$ 40,449,794</u>

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, 2011 and 2010, the Foundation has uncalled commitments of \$400,227 and \$439,887, respectively.

Alternative investments are comprised of the following at June 30, 2011:

<u>Investment Type</u>	<u>Amount</u>	<u>Liquidity</u>
Domestic/ U.S. Limited Partnerships	\$ 1,408,547	None until dissolution or winding up of partnership.
Domestic/ U.S. Limited Partnerships	1,855,651	No lock up.
Domestic/ U.S. Limited Partnerships	6,112,681	Last day of each quarter.
Offshore investment funds	<u>7,950,264</u>	Last day of each quarter.
ALTERNATIVE INVESTMENTS	<u>\$17,327,143</u>	

Alternative investments are comprised of the following at June 30, 2010:

<u>Investment Type</u>	<u>Amount</u>	<u>Liquidity</u>
Domestic/ U.S. Limited Partnerships	\$ 1,380,129	None until dissolution or winding up of partnership.
Domestic/ U.S. Limited Partnerships	1,840,488	No lock up.
Domestic/ U.S. Limited Partnerships	4,360,967	Last day of each quarter.
Offshore investment funds	<u>7,102,332</u>	Last day of each quarter.
ALTERNATIVE INVESTMENTS	<u>\$14,683,916</u>	

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

2. INVESTMENTS (Continued)

Included in the investment balance at June 30, 2011 and 2010 are investments related to certain split-interest agreements in the amounts of \$1,330,733 and \$1,390,992, respectively.

In 2009, Maryland signed into law the Uniform Prudent Management of Institutional Funds Act of 2007 (UPMIFA). The law became effective April 14, 2009. The Foundation implemented FSP-117-1 in 2009 and evaluated its endowment funds to ensure compliance with UPMIFA. As a result of following UPMIFA, 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. 5% spending is included in the Statement of Activities and Change in Net Assets in investment income. All earnings that exceed this target and all losses in a given year are considered non-operating and are shown as capital additions (deductions) in the Statement of Activities and Change in Net Assets as investment return, net.

Investment returns for the years ended June 30, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Interest and dividends	\$ 457,558	\$ 507,635
Unrealized gain	6,244,469	4,305,501
Realized gain (loss)	<u>49,767</u>	<u>(1,056,653)</u>
Total investment return	6,751,794	3,756,483
Less: Investment income used for operations	<u>(1,983,546)</u>	<u>(2,114,249)</u>
NET INVESTMENT RETURN	<u>\$ 4,768,248</u>	<u>\$ 1,642,234</u>

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, 2011 and 2010, respectively:

	<u>2011</u>	<u>2010</u>
Federal receivables	\$ 1,355,431	\$ 5,970,700
Non-Federal receivables	<u>182,098</u>	<u>302,729</u>
Total accounts receivable	1,537,529	6,273,429
Less: Allowance for doubtful accounts	<u>(16,619)</u>	<u>(2,856)</u>
NET ACCOUNTS RECEIVABLE	<u>\$ 1,520,910</u>	<u>\$ 6,270,573</u>

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

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, 2012. Only monthly payments of interest are to be made by the Tribe until maturity. The amount outstanding at June 30, 2011 and 2010 was \$103,000.

5. PLEDGES RECEIVABLE

As of June 30, 2011 and 2010, contributors to the Foundation have made written promises to give totaling \$9,610,909 and \$10,632,785, 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 1.25% 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. Pledges are due as follows at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Less than one year	\$ 1,136,379	\$ 1,170,517
One to five years	1,655,882	2,280,816
Beyond five years	<u>6,818,648</u>	<u>7,181,452</u>
Total pledges	9,610,909	10,632,785
Less: Discount to net present value	(2,797,446)	(3,045,250)
Less: Allowance for doubtful accounts	<u>(95,090)</u>	<u>(105,212)</u>
NET PLEDGES RECEIVABLE	<u>\$ 6,718,373</u>	<u>\$ 7,482,323</u>

6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Land	\$ 10,315,411	\$ 10,315,411
Building and improvements	15,205,015	15,097,565
Furniture and equipment	3,169,957	3,294,055
Boats	3,688,747	3,732,282
Vehicles	480,656	432,856
Construction in progress	146,779	-
Art	<u>17,000</u>	<u>17,000</u>
Total property and equipment	33,023,565	32,889,169
Less: Accumulated depreciation and amortization	<u>(12,803,230)</u>	<u>(12,282,039)</u>
NET PROPERTY AND EQUIPMENT	<u>\$ 20,220,335</u>	<u>\$ 20,607,130</u>

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 and \$7,916,052 at June 30, 2011 and 2010, respectively.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

7. NOTE PAYABLE

In January 2007, the Foundation entered into a \$746,000 purchase money note payable to a trust. The annual interest rate is 5.62%. The maturity date is March 2022.

As of June 30, 2011 and 2010, the outstanding principal of the note payable was \$609,051 and \$648,143, respectively.

Principal payments are due as follows:

<u>Year Ended June 30.</u>	
2012	\$ 41,321
2013	43,677
2014	46,168
2015	48,801
2016	51,584
2017 and Thereafter	<u>377,500</u>
	<u>\$ 609,051</u>

8. BONDS PAYABLE

On July 6, 1998, the Foundation purchased a 30.261-acre parcel of land, the Bay Ridge Facility, located just outside the city of Annapolis, Maryland, for its central headquarters for approximately \$3.7 million. A \$4 million bridge loan from Wells Fargo Bank, N.A. (formerly known as Wachovia Bank) was used to purchase the site.

On November 1, 1998, the Foundation issued variable rate bonds ("Variable Rate Economic Development Revenue Bonds, Series 1998") in the amount of \$10 million through the Maryland Economic Development Corporation. Wells Fargo Bank was trustee for the bonds (On December 30, 2005, U.S. Bank, N.A. completed the purchase of the corporate trust and institutional custody businesses of Wells Fargo Corporation and became the successor Trustee). The proceeds of the bonds were used to repay the bridge loan with Wells Fargo Bank, N.A. and finance the acquisition, construction and equipping of a portion of the Bay Ridge Facility. In December 2000, the Foundation moved into its U.S. Green Building Council LEED Platinum headquarters, a facility called the Philip Merrill Environmental Center, and widely recognized as one of the most environmentally innovative buildings in the world.

The facilities include a two-story, 30,000 square foot "green" office building and common meeting centers for internal and external groups. Since moving to the Merrill Center, much of the site has been restored with native plants, and there are plans to continue native restoration. Interest only payments were due on the bonds until November 2001, when mandatory sinking fund and interest payments were due monthly with the final payment due October 1, 2023. Financing costs in the amount of \$135,501 were capitalized and amortized over the life of the bonds. At June 30, 2011 and 2010, deferred financing costs, net of accumulated amortization, totaled \$67,751 and \$73,171, respectively.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

8. BONDS PAYABLE (Continued)

The bonds are secured by a letter of credit issued by Wells Fargo Bank in the amount of \$7,140,939. It matured on October 31, 2011, and was renewed until October 31, 2012. The letter of credit is secured by the Foundation's interest in the facility fund, the bond fund, and all funds that are under the control of Wells Fargo Bank. The bonds bear interest at variable rates that is determined weekly by Wells Fargo Capital Markets in order to place the bonds at 100% par with a final maturity date of November 1, 2023. 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 year ending June 30, 2011 the Foundation is in compliance with all bond covenants. For the year ended June 30, 2010, the Foundation was not in compliance with the bond covenants. The Foundation received a waiver from the creditor.

The Foundation has cash held in a bond sinking fund in the amounts of \$331,201 and \$307,232 for the years ending June 30, 2011 and 2010, respectively.

As of June 30, 2011 and 2010, the outstanding principal of the bond payable totaled \$7,030,000 and \$7,420,000, respectively.

Principal payments are due as follows:

<u>Year Ended June 30,</u>	
2012	\$ 410,000
2013	425,000
2014	445,000
2015	465,000
2016	490,000
2017 and Thereafter	<u>4,795,000</u>
BONDS PAYABLE	<u>\$ 7,030,000</u>

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) Index. As a means to reduce its exposure to volatility in the variable rate index (SIFMA), the Foundation entered into the following interest rate swap agreements with Wells Fargo Bank, N.A. in connection with its Variable Rate Economic Development Revenue Bonds, Series 1998. The intention of the swap agreement is to synthetically fix the interest rate on the bonds.

On November 5, 1998, the Foundation entered into an interest-rate swap agreement to fix one-half of its outstanding variable rate bonds at a synthetic fixed rate of 5.00%. On January 6, 2004, one-quarter of the remaining variable rate bonds was synthetically fixed at a rate of 3.25%. On May 26, 2005, the Foundation cancelled all previous interest-rate swap agreements and fixed the outstanding notional of \$9,140,000 to a synthetic fixed rate of 4.33%. Interest on the swap is due monthly.

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

9. INTEREST RATE SWAP (Continued)

The Foundation incurred total interest expense on the bonds of \$309,291 and \$325,997 for the years ended June 30, 2011 and 2010, respectively, which is included in occupancy and utilities expense within the Statement of Functional Expenses.

The bonds and the related swap agreement mature on November 1, 2023 and the swap notional amount of \$9,140,000 will hedge 100% of the outstanding variable-rate bonds as of the effective date of the swap, June 1, 2005. Starting in fiscal year 2006, the combined notional value of the swap and the combined principal amount of the associated debt will decline. For the years ended June 30, 2011 and 2010, the outstanding notional amount was \$7,030,000 and \$7,420,000, respectively. Under the swap, the Foundation pays Wells Fargo Bank a fixed rate of 4.33% and receives a variable rate at SIFMA.

As of June 30, 2011 and 2010, the swap had a negative fair value of \$905,112 and \$985,756, respectively, which is reflected in the financial statements.

The swap valuations were established by market quotations from Wells Fargo Bank representing estimates of the amounts that would be paid upon terminating the agreement.

As of June 30, 2011, the Foundation was not exposed to credit risk because the swap had a negative fair value. The Foundation is only exposed to credit risk if the swap has a positive fair value. The swap counterparty (Wells Fargo Bank) was rated Aa2 by Moody's Investors Service (Moody's), AA by Standard and Poor's (S&P) and AA- by Fitch Ratings (Fitch). Subsequent to year-end, Moody's rating was downgraded to Aa3. In addition, since the swap agreement was executed to the maturity of the underlying bonds there is no rollover risk.

The SIFMA swap exposes the Foundation to basis risk should the actual rate on the Foundation's bonds exceed the SIFMA Index. Since the Foundation's bonds are based upon the SIFMA Index, there is relatively little basis risk. Should the Foundation terminate the swap prior to maturity, the Foundation will either receive or pay a termination payment. This payment is equal to the fair value of the swap at the time the swap is terminated.

10. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Program Restricted:		
Environmental Education	\$ 385,238	\$ 359,451
Environmental Protection and Restoration	1,760,334	2,167,713
Communications	2,500	-
Property and Equipment	250,495	29,829
Other	<u>130,986</u>	<u>38,536</u>
Total program restricted	2,529,553	2,595,529
Time Restricted	<u>6,579,956</u>	<u>5,570,743</u>
TEMPORARILY RESTRICTED NET ASSETS	<u>\$ 9,109,509</u>	<u>\$ 8,166,272</u>

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

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, 2011 and 2010 are as follows:

	2011	2010
With purpose restrictions	\$ 2,675,043	\$ 1,991,671
Time restriction	771,450	145,210
ACCUMULATED ENDOWMENT EARNINGS INCLUDED IN TEMPORARILY RESTRICTED NET ASSETS	<u>\$ 3,446,493</u>	<u>\$ 2,136,881</u>

Temporarily Restricted Net Assets Released from Restrictions:

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:

	2011	2010
Donor Restrictions:		
Environmental Education	\$ 1,113,931	\$ 1,605,087
Environmental Protection and Restoration	2,316,291	1,677,758
Communications	40,000	10,000
Property and Equipment	253,795	196,744
Other	74,131	156,511
Total donor restrictions	3,798,148	3,646,100
Time Restricted	2,006,241	4,836,754
NET ASSETS RELEASED FROM RESTRICTIONS	<u>\$ 5,804,389</u>	<u>\$ 8,482,854</u>

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, 2011

11. LEASE COMMITMENT (Continued)

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

<u>Year Ended June 30,</u>	
2012	\$ 191,177
2013	136,457
2014	136,692
2015	<u>56,109</u>
LEASE COMMITMENT	<u>\$ 520,435</u>

Rent expense for the years ended June 30, 2011 and 2010 totaled \$243,665 and \$223,519, 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, 2011 and 2010, the Foundation made contributions in the amounts of \$360,954 and \$361,565, respectively.

13. RELATED PARTY

For the years ended June 30, 2011 and 2010, the Foundation received gross contributions and grants in the amounts of \$3,887,512 and \$2,019,356, respectively, from Trustees, Executive Management, and their associated companies. Net amounts due under pledges receivable from related parties totaled \$1,320,786 and \$1,378,827 as of June 30, 2011 and 2010, respectively. Net amounts due under accounts receivable from related parties totaled \$266,326 and \$84,479 as of June 30, 2011 and 2010, respectively.

14. CONTINGENCY

The Foundation receives grants from various agencies of the United States Government. Such grants are subject to audit under the provisions of OMB Circular A-133. 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 provisions of OMB Circular A-133 have been completed for all required fiscal years through 2011.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2011

14. CONTINGENCY (Continued)

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.

15. DONATED GOODS, SERVICES, AND PROPERTY

During the years ended June 30, 2011 and 2010, 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 \$1,817,972 and \$410,613 have been included in revenue and expense for the years ended June 30, 2011 and 2010, respectively, which included \$1,670,200 of in-kind public service announcements for the year ended June 30, 2011. In addition, the Foundation was the beneficiary of donated property and equipment totaling \$8,000 and \$10,650 for the years ended June 30, 2011 and 2010, respectively. These assets were capitalized at their fair value and the income is recognized in the Statement of Activities and Change in Net Assets.

16. FAIR VALUE MEASUREMENTS

In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, 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 financial instruments where values are based on unadjusted quoted prices for identical assets or liabilities in an active market the Foundation has the ability to access.

Level 2. These are financial instruments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full-term of the investments. The fair value estimates of equity securities and corporate bonds and other agencies are based on observable market information, rather than market quotes. Accordingly, the estimates of fair value for such fixed maturity investments, as provided by the pricing service, are included in the amount disclosed in the Level 2 of the hierarchy.

Level 3. These are financial instruments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the financial instruments. These financial instruments include non-readily marketable securities that do not have an active market.

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

16. FAIR VALUE MEASUREMENTS (Continued)

Financial instruments recorded in the Statement of Financial Position are categorized based on the inputs to the valuation technique as follows for the year ended June 30, 2011:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total June 30, 2011</u>
Assets:				
Equity securities	\$ 19,428,412	\$ 647,464	\$ -	\$ 20,075,876
Partnerships/Alternative investments	-	-	17,327,143	17,327,143
Corporate bonds and other agencies	599,474	31,913	-	631,387
Beneficial interest in perpetual trust	2,924,350	-	-	2,924,350
U.S. Government obligations	39,381	-	-	39,381
Cash and cash equivalents held by investment managers	<u>4,139,542</u>	<u>-</u>	<u>-</u>	<u>4,139,542</u>
Total Investments	<u>\$ 27,131,159</u>	<u>\$ 679,377</u>	<u>\$ 17,327,143</u>	<u>\$ 45,137,679</u>
Liability:				
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ 905,112</u>	<u>\$ -</u>	<u>\$ 905,112</u>

Financial instruments recorded in the Statement of Financial Position are categorized based on the inputs to the valuation technique as follows for the year ended June 30, 2010:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total June 30, 2010</u>
Assets:				
Equity securities	\$ 13,136,358	\$ 641,446	\$ -	\$ 13,777,804
Partnerships/Alternative investments	-	-	14,683,916	14,683,916
Corporate bonds and other agencies	7,180,759	284,978	-	7,465,737
Beneficial interest in perpetual trust	2,924,350	-	-	2,924,350
U.S. Government obligations	37,728	-	-	37,728
Cash and cash equivalents held by investment managers	<u>1,560,259</u>	<u>-</u>	<u>-</u>	<u>1,560,259</u>
Total Investments	<u>\$ 24,839,454</u>	<u>\$ 926,424</u>	<u>\$ 14,683,916</u>	<u>\$ 40,449,794</u>
Liability:				
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ 985,756</u>	<u>\$ -</u>	<u>\$ 985,756</u>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

16. FAIR VALUE MEASUREMENTS (Continued)

Level 3 Financial Assets

Following is the change in fair value of the Foundation's assets using significant unobservable inputs (Level 3) for the years ended June 30, 2011 and 2010:

	<u>Investments</u>
Beginning balance as of July 1, 2009	\$ 11,247,954
Unrealized and realized gains	1,170,062
Earned income	134,470
Purchases	<u>2,131,430</u>
BALANCE AS OF JUNE 30, 2010	14,683,916
Unrealized and realized gains	1,970,498
Earned income	211,800
Purchases	<u>460,929</u>
BALANCE AS OF JUNE 30, 2011	<u>\$ 17,327,143</u>

17. ENDOWMENT

In August of 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 117-1, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of The Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds. The FASB Staff Position (FSP 117-1) provides guidance on the net asset classification of donor-restricted endowment funds for a non-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006. In 2009, Maryland signed into law the Uniform Prudent Management of Institutional Funds Act of 2007 (UPMIFA). The law became effective April 14, 2009.

The Foundation's 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. 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 Footnote Note 10, total endowments funds classified as temporarily restricted net assets.)

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

17. ENDOWMENT (Continued)

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:

	2011	2010
Environmental Education	\$ 8,456,826	\$ 8,054,097
Environmental Protection and Restoration	8,574,325	8,574,325
Property and equipment	7,916,052	7,916,052
General operating	<u>14,136,048</u>	<u>14,128,206</u>
PERMANENTLY RESTRICTED NET ASSETS	<u>\$ 39,083,251</u>	<u>\$ 38,672,680</u>

Changes in endowment net assets for the year ended June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ <u>(2,743,620)</u>	\$ <u>2,136,881</u>	\$ <u>38,672,680</u>	\$ <u>38,065,941</u>
Interest and dividends	-	296,827	-	296,827
Net appreciation of investments	<u>2,233,859</u>	<u>2,458,114</u>	<u>-</u>	<u>4,691,973</u>
Total investment return	<u>2,233,859</u>	<u>2,754,941</u>	<u>-</u>	<u>4,988,800</u>
Contributions	-	-	171,099	171,099
Appropriation of endowment assets for expenditure	-	(1,445,328)	-	(1,445,328)
Other changes:				
Transfer of net assets	<u>-</u>	<u>-</u>	<u>239,472</u>	<u>239,472</u>
ENDOWMENT NET ASSETS, END OF YEAR	<u>\$ (509,761)</u>	<u>\$ 3,446,494</u>	<u>\$ 39,083,251</u>	<u>\$ 42,019,984</u>

During fiscal year 2011, management transferred \$239,472 from unrestricted net assets to permanently restricted net assets based on donor intent.

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

17. ENDOWMENT (Continued)

Changes in endowment net assets for the year ended June 30, 2010:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (3,698,919)	\$ 1,812,239	\$ 38,641,263	\$36,754,583
Interest and dividends	-	354,098	-	354,098
Net appreciation of investments	<u>955,299</u>	<u>1,530,038</u>	<u>-</u>	<u>2,485,337</u>
Total investment return	<u>955,299</u>	<u>1,884,136</u>	<u>-</u>	<u>2,839,435</u>
Contributions	-	-	31,417	31,417
Appropriation of endowment assets for expenditure	<u>-</u>	<u>(1,559,494)</u>	<u>-</u>	<u>(1,559,494)</u>
ENDOWMENT NET ASSETS, END OF YEAR	<u>\$(2,743,620)</u>	<u>\$ 2,136,881</u>	<u>\$ 38,672,680</u>	<u>\$38,065,941</u>

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 the State of Maryland Prudent Management of Institutional Funds Act (SPMIFA) requires the Foundation to retain into perpetuity. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$509,761 and \$2,743,620 as of June 30, 2011 and 2010, 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.

CHESAPEAKE BAY FOUNDATION, INC.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011**

17. ENDOWMENT (Continued)

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 November 14, 2011, the date the financial statements were issued.



GELMAN, ROSENBERG & FREEDMAN
CERTIFIED PUBLIC ACCOUNTANTS

**INDEPENDENT AUDITORS' REPORT ON
SUPPLEMENTAL FINANCIAL INFORMATION**

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

Our report on our audit of the basic financial statements of the Chesapeake Bay Foundation, Inc. as of June 30, 2011 appears on page 2. The audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Summary of Conservation and Scenic Easements 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 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Gelman Rosenberg & Freedman

November 14, 2011

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MEMBER OF CPAMERICA INTERNATIONAL, AN AFFILIATE OF HORWATH INTERNATIONAL
MEMBER OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' PRIVATE COMPANIES PRACTICE SECTION

CHESAPEAKE BAY FOUNDATION, INC.

**SUMMARY OF CONSERVATION AND SCENIC EASEMENTS
FOR INFORMATION PURPOSES ONLY (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2011**

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, 2011.

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 850 acres along the Sassafras River in Cecil County, Maryland, known as Sheffield and Rose Hill Farms

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 13 acres along the Craddock Creek in Accomack County, Virginia
- Approximately 20 acres along Back Creek in Accomack County, Virginia
- Approximately 20 acres along Brush Creek in Frederick County, Virginia
- Approximately 22 acres in Accomack County, Virginia
- Approximately 29 acres along Nandua Creek in Accomack 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 Hunting Creek in Accomack County, Virginia
- Approximately 40 acres along Pitts Creek in Accomack County, Virginia
- Approximately 41 acres along Occohannock Creek in Accomack County, Virginia
- Approximately 45 acres along the Totuskey Creek in Richmond County, Virginia
- Approximately 63 acres along the Chesapeake Bay in Northampton County, Virginia
- Approximately 72 acres in King & Queen County, Virginia
- Approximately 72 acres along the Chesapeake Bay in Northumberland County, Virginia
- Approximately 90 acres along Bullbegger Creek in Accomack County, Virginia
- Approximately 94 acres along Barnes Creek in Northumberland County, Virginia
- Approximately 99 acres on unnamed tributary to Pitts Creek in Accomack County, Virginia
- Approximately 106 acres on Pungoteague Creek in Accomack County, Virginia
- Approximately 118 acres along Mountain Run in Orange County, Virginia
- Approximately 118 acres along Occohannock Creek in Northampton County, Virginia
- Approximately 128 acres along Tawes Creek in Accomack County, Virginia
- Approximately 145 acres along Cherrystone Inlet in Northampton County, Virginia
- Approximately 150 acres along the Chesapeake Bay in Mathews County, Virginia
- Approximately 157 acres along the Middle River in Augusta County, Virginia
- Approximately 161 acres in Northampton County, Virginia
- Approximately 161 acres along Holdens Creek in Accomack County, Virginia
- Approximately 179 acres along Messongo Creek in Accomack County, Virginia

CHESAPEAKE BAY FOUNDATION, INC.

**SUMMARY OF CONSERVATION AND SCENIC EASEMENTS
FOR INFORMATION PURPOSES ONLY (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2011**

Virginia (Continued)

- Approximately 210 acres along Nassawadox Creek in Northampton County, Virginia
- Approximately 241 acres along Holly Grove Cove in Northampton County, Virginia
- Approximately 256 acres in Stafford County, Virginia
- Approximately 345 acres along the Chesapeake Bay in Accomack County, Virginia
- Approximately 411 acres along Jacobus Creek in County, Virginia
- Approximately 601 acres in Accomack County, Virginia