

# FINANCIAL STATEMENTS



**CHESAPEAKE BAY FOUNDATION**

*Saving a National Treasure*

**FOR THE YEAR ENDED JUNE 30, 2012  
WITH SUMMARIZED FINANCIAL  
INFORMATION FOR 2011**

# CHESAPEAKE BAY FOUNDATION, INC.

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## 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, 2012, 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, 2011 and, in our report dated November 14, 2011, 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, 2012, and the change in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2012 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.

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

December 10, 2012

**CHESAPEAKE BAY FOUNDATION, INC.**  
**STATEMENT OF FINANCIAL POSITION**  
**AS OF JUNE 30, 2012**  
**WITH SUMMARIZED FINANCIAL INFORMATION FOR 2011**

**ASSETS**

	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 5,363,991	\$ 5,879,623
Investments (Notes 2 and 16)	46,598,428	45,137,679
Cash held in bond sinking fund (Note 8)	335,110	331,201
Accounts receivable, less allowance for doubtful accounts of \$2,064 and \$16,619 for 2012 and 2011, respectively (Notes 3 and 13)	1,195,942	1,520,910
Note receivable (Note 4)	102,900	103,000
Pledges receivable, net of allowance for doubtful accounts of \$179,837 and \$95,090 for 2012 and 2011, respectively (Notes 5 and 13)	15,093,537	6,718,373
Other assets	462,566	401,161
Deferred financing cost, net of accumulated amortization of \$73,170 and \$67,750 for 2012 and 2011, respectively (Note 8)	62,331	67,751
Property and equipment, net of accumulated depreciation and amortization of \$13,423,553 and \$12,803,230 for 2012 and 2011, respectively (Note 6)	<u>20,640,307</u>	<u>20,220,335</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 89,855,112</u></b>	<b><u>\$ 80,380,033</u></b>

**LIABILITIES AND NET ASSETS**

**LIABILITIES**

Note payable (Note 7)	\$ -	\$ 609,051
Bonds payable (Note 8)	6,620,000	7,030,000
Accounts payable and accrued expenses	1,511,915	2,090,908
Deferred income	282,467	157,838
Liability under split interest agreements	932,507	878,468
Interest rate swap obligation (Notes 9 and 16)	1,276,494	905,112
Income taxes payable on sale of debt financed property	<u>1,085,734</u>	<u>-</u>
Total liabilities	<u>11,709,117</u>	<u>11,671,377</u>

**NET ASSETS**

Unrestricted	19,136,675	20,515,896
Temporarily restricted (Note 10)	15,236,052	9,109,509
Permanently restricted (Note 17)	<u>43,773,268</u>	<u>39,083,251</u>
Total net assets	<u>78,145,995</u>	<u>68,708,656</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 89,855,112</u></b>	<b><u>\$ 80,380,033</u></b>

See accompanying notes to financial statements.

## CHESAPEAKE BAY FOUNDATION, INC.

**STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS  
FOR THE YEAR ENDED JUNE 30, 2012  
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2011**

	2012			2011	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<b>REVENUE</b>					
Membership contributions	\$ 5,038,650	\$ -	\$ -	\$ 5,038,650	\$ 5,032,299
Grants and gifts (Notes 13 and 14)	8,757,579	12,378,976	-	21,136,555	16,962,829
Education contracts and tuition	1,033,464	-	-	1,033,464	980,780
Investment income (Note 2)	620,778	1,496,497	-	2,117,275	1,983,546
Donated goods and services (Note 15)	1,718,693	-	-	1,718,693	1,817,972
Other	436,860	-	-	436,860	511,750
Net assets released from donor restrictions (Note 10)	<u>6,851,163</u>	<u>(6,851,163)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total revenue	<u>24,457,187</u>	<u>7,024,310</u>	<u>-</u>	<u>31,481,497</u>	<u>27,289,176</u>
<b>EXPENSES</b>					
Program Services:					
Environmental Education	6,088,893	-	-	6,088,893	6,812,969
Environmental Protection and Restoration	10,187,881	-	-	10,187,881	14,069,495
Communications	<u>3,302,440</u>	<u>-</u>	<u>-</u>	<u>3,302,440</u>	<u>3,174,121</u>
Total program services	<u>19,579,214</u>	<u>-</u>	<u>-</u>	<u>19,579,214</u>	<u>24,056,585</u>
Support Services:					
General and Administrative	1,819,704	-	-	1,819,704	1,776,609
Fundraising	<u>3,126,159</u>	<u>-</u>	<u>-</u>	<u>3,126,159</u>	<u>3,227,705</u>
Total support services	<u>4,945,863</u>	<u>-</u>	<u>-</u>	<u>4,945,863</u>	<u>5,004,314</u>
Total expenses	<u>24,525,077</u>	<u>-</u>	<u>-</u>	<u>24,525,077</u>	<u>29,060,899</u>
Change in net assets before capital additions (deductions)	<u>(67,890)</u>	<u>7,024,310</u>	<u>-</u>	<u>6,956,420</u>	<u>(1,771,723)</u>
<b>CAPITAL ADDITIONS (DEDUCTIONS)</b>					
Investment return, net (Note 2)	(1,964,176)	(897,767)	59	(2,861,884)	4,768,248
Realized gain on sale of debt financed property (Note 2)	1,984,368	-	-	1,984,368	-
Income tax on sale of debt financed property	(1,085,734)	-	-	(1,085,734)	-
Grants and gifts (Note 13)	-	-	4,689,958	4,689,958	11,106
Donated property (Note 15)	140,062	-	-	140,062	8,000
Loss on sale/transfer of property	(14,469)	-	-	(14,469)	(54,564)
Unrealized (loss) gain on interest rate swap (Note 9)	<u>(371,382)</u>	<u>-</u>	<u>-</u>	<u>(371,382)</u>	<u>80,644</u>
Total capital additions (deductions)	<u>(1,311,331)</u>	<u>(897,767)</u>	<u>4,690,017</u>	<u>2,480,919</u>	<u>4,813,434</u>
Change in net assets	(1,379,221)	6,126,543	4,690,017	9,437,339	3,041,711
Net assets at beginning 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>
<b>NET ASSETS AT END OF YEAR</b>	<b><u>\$ 19,136,675</u></b>	<b><u>\$ 15,236,052</u></b>	<b><u>\$ 43,773,268</u></b>	<b><u>\$ 78,145,995</u></b>	<b><u>\$ 68,708,656</u></b>

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF FUNCTIONAL EXPENSES  
FOR THE YEAR ENDED JUNE 30, 2012  
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2011

	<u>Program Services</u>			<u>2012</u>
	<u>Environmental</u>	<u>Environmental</u>	<u>Communications</u>	<u>Total</u>
	<u>Education</u>	<u>Protection and</u>		<u>Program</u>
		<u>Restoration</u>		<u>Services</u>
Salaries	\$ 2,281,270	\$ 3,503,846	\$ 1,040,580	\$ 6,825,696
Fringe benefits (Note 12)	874,777	1,335,765	413,225	2,623,767
Supplies	253,649	157,071	32,207	442,927
Restoration supplies	-	217,941	-	217,941
Telephone	58,578	95,169	16,765	170,512
Postage and shipping	128,210	228,645	142,475	499,330
Occupancy and utilities (Notes 6, 9 and 11)	518,399	597,346	121,304	1,237,049
Equipment rental, leasing, repairs and maintenance	144,549	99,750	19,907	264,206
Printing and publications	144,876	276,405	242,004	663,285
Dues and subscriptions	1,124	32,940	2,126	36,190
Travel	201,099	128,794	13,837	343,730
Meetings and seminars	48,518	85,913	14,363	148,794
Outside services	19,836	36,999	78,548	135,383
Boat charter	39,953	3,280	150	43,383
Professional fees	170,812	1,060,800	383,535	1,615,147
Restoration fees	-	392,579	-	392,579
Personnel recruitment	-	397	-	397
Miscellaneous	2,901	35,562	1,527	39,990
Mailing preparation	43,128	72,413	23,436	138,977
Honorariums/stipends	6,000	355	-	6,355
Insurance	156,176	83,292	11,027	250,495
List rentals	38,841	64,943	21,107	124,891
Depreciation and amortization - other (Note 6)	178,044	89,229	9,481	276,754
Subcontracts	-	509,846	-	509,846
Donated goods and services (Note 15)	<u>494,260</u>	<u>604,328</u>	<u>560,886</u>	<u>1,659,474</u>
Sub-total	5,805,000	9,713,608	3,148,490	18,667,098
Allocation of management and general	<u>283,893</u>	<u>474,273</u>	<u>153,950</u>	<u>912,116</u>
<b>TOTAL</b>	<b><u>\$ 6,088,893</u></b>	<b><u>\$ 10,187,881</u></b>	<b><u>\$ 3,302,440</u></b>	<b><u>\$19,579,214</u></b>

See accompanying notes to financial statements.

					2011
<u>Support Services</u>					
<u>General and Administrative</u>	<u>Fundraising</u>	<u>Total Support Services</u>	<u>Total Expenses</u>	<u>Total Expenses</u>	
\$ 1,377,403	\$ 1,124,690	\$ 2,502,093	\$ 9,327,789	\$ 9,292,193	
544,245	449,030	993,275	3,617,042	3,508,352	
48,009	61,858	109,867	552,794	537,148	
-	-	-	217,941	249,204	
10,876	13,150	24,026	194,538	173,361	
3,622	243,042	246,664	745,994	811,664	
297,407	116,574	413,981	1,651,030	1,685,588	
55,520	29,323	84,843	349,049	347,303	
904	280,592	281,496	944,781	1,040,611	
3,346	2,804	6,150	42,340	52,097	
25,619	24,065	49,684	393,414	388,839	
52,853	53,193	106,046	254,840	306,199	
45,934	79,298	125,232	260,615	290,872	
-	-	-	43,383	48,763	
316,447	240,958	557,405	2,172,552	2,364,338	
-	-	-	392,579	738,279	
16,133	-	16,133	16,530	12,587	
20,352	13,958	34,310	74,300	67,651	
-	100,366	100,366	239,343	244,549	
-	-	-	6,355	699	
37,737	20,430	58,167	308,662	308,912	
-	58,856	58,856	183,747	303,873	
21,160	9,006	30,166	306,920	309,505	
-	-	-	509,846	4,160,340	
-	59,219	59,219	1,718,693	1,817,972	
2,877,567	2,980,412	5,857,979	24,525,077	29,060,899	
(1,057,863)	145,747	(912,116)	-	-	
<b>\$ 1,819,704</b>	<b>\$ 3,126,159</b>	<b>\$ 4,945,863</b>	<b>\$ 24,525,077</b>	<b>\$ 29,060,899</b>	

See accompanying notes to financial statements.



## CHESAPEAKE BAY FOUNDATION, INC.

**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED JUNE 30, 2012**  
**WITH SUMMARIZED FINANCIAL INFORMATION FOR 2011**

	<u>2012</u>	<u>2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 9,437,339	\$ 3,041,711
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation and amortization	846,216	852,844
Unrealized loss (gain) on interest rate swap	371,382	(80,644)
Loss on sale of property and equipment	14,469	54,564
Donated property	(140,062)	(8,000)
Capital additions - permanently restricted contributions	(4,689,958)	(11,106)
Change in the discount of long-term pledges receivable	166,047	(247,804)
Change in allowance for doubtful accounts	70,192	3,641
Unrealized loss (gain) on investments	2,576,601	(6,244,469)
Realized gains on investments (including realized gain on sale of debt financed property)	(2,471,263)	(49,767)
Change in value of split interest agreements	69,452	140,937
(Increase) decrease in:		
Accounts receivable	339,523	4,735,900
Pledges receivable	(8,625,958)	1,021,876
Other assets	(61,405)	27,507
Increase (decrease) in:		
Accounts payable and accrued expenses	(578,993)	(5,096,850)
Deferred income	124,629	41,811
Liability under split interest agreements	-	(49,133)
Income taxes payable on sale of debt financed property	<u>1,085,734</u>	<u>-</u>
Net cash used by operating activities	<u>(1,466,055)</u>	<u>(1,866,982)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net (purchases) proceeds from sale of investments	(1,566,087)	1,606,351
Purchases of property and equipment	(1,146,375)	(542,263)
Proceeds from sale of property and equipment	11,200	35,070
Proceeds from note receivable	<u>100</u>	<u>-</u>
Net cash (used) provided by investing activities	<u>(2,701,162)</u>	<u>1,099,158</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Capital additions - permanently restricted contributions	4,689,958	11,106
Increase in cash held for bond sinking fund	(3,909)	(23,969)
Payments on bonds payable	(410,000)	(390,000)
Payments on note payable	(609,051)	(39,092)
Proceeds from split interest agreements	77,916	25,586
Payments made on split interest agreements	<u>(93,329)</u>	<u>(116,956)</u>
Net cash provided (used) by financing activities	<u>3,651,585</u>	<u>(533,325)</u>

See accompanying notes to financial statements.

CHESAPEAKE BAY FOUNDATION, INC.

STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2012  
WITH SUMMARIZED FINANCIAL INFORMATION FOR 2011

	<u>2012</u>	<u>2011</u>
Net decrease in cash and cash equivalents	\$ (515,632)	\$ (1,301,149)
Cash and cash equivalents at beginning of year	<u>5,879,623</u>	<u>7,180,772</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b><u>\$ 5,363,991</u></b>	<b><u>\$ 5,879,623</u></b>
 <b>SUPPLEMENTAL INFORMATION:</b>		
Interest Paid	<b><u>\$ 535,820</u></b>	<b><u>\$ 454,482</u></b>
Taxes Paid	<b><u>\$ 15,981</u></b>	<b><u>\$ 22,144</u></b>

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**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, 2011, 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, and excluding cash and cash equivalents held by investment managers in the amounts of \$2,804,103 and \$4,139,542 for the years ended June 30, 2012 and 2011, respectively, to be cash equivalents.

Through December 31, 2012, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all Federal Deposit Insurance Corporation (FDIC) - insured depository institutions (the "Dodd-Frank Deposit Insurance Provision"). The Foundation maintains a portion of its cash balances at financial institutions in noninterest-bearing accounts; thereby, all of these cash balances are protected by the FDIC under this Act.

At times during the year, the Foundation maintains a portion of its 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.

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

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

Investments (continued) -

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.

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 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.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

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

Property and equipment (continued) -

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. 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, 2012 and 2011, liabilities under split interest agreements totaled \$932,507 and \$878,468, 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 its investments and the sale of debt financed investment property.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

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

Income taxes (continued) -

Accordingly, the Foundation has recorded income tax expense in the amount of \$1,097,251 and \$26,027 for the years ended June 30, 2012 and 2011, as follows:

	<u>2012</u>	<u>2011</u>
Income tax on sale of debt financed property	\$ 1,085,734	\$ -
Other unrelated business income tax included in miscellaneous expenses in the accompanying Statement of Functional Expenses	<u>11,517</u>	<u>26,027</u>
<b>TOTAL INCOME TAXES PAYABLE</b>	<b><u>\$ 1,097,251</u></b>	<b><u>\$ 26,027</u></b>

An unrelated business income tax in the amount of \$6,038 and \$10,313 was recorded as a liability and included in accounts payable in the Statement of Financial Position as of June 30, 2012 and 2011, respectively. The taxes payable from the sale of the debt financed property of \$1,085,734 during the year ended June 30, 2012 is presented separately in the Statement of Financial Position.

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, 2012 and 2011, 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.

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

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

Joint costs -

For fiscal years 2012 and 2011, the Foundation incurred joint costs of \$2,424,347 and \$2,665,993, respectively, for educational materials, membership and support services. These costs were allocated as follows:

	<b>2012</b>	<b>2011</b>
Environmental Education	\$ 450,558	\$ 498,667
Environmental Protection and Restoration	947,124	1,048,254
Communications	188,790	208,948
Fundraising	837,875	910,124
<b>TOTAL JOINT COSTS INCURRED</b>	<b>\$ 2,424,347</b>	<b>\$ 2,665,993</b>

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.

**2. INVESTMENTS**

At June 30, 2012 and 2011, investments at readily determinable fair values, consisted of the following:

	<b>2012</b>	<b>2011</b>
Equity securities	\$ 22,031,008	\$ 20,075,876
Partnerships/Alternative investments	16,014,837	17,327,143
Corporate bonds and other agencies	2,785,313	631,387
Beneficial interest in perpetual trust	2,924,350	2,924,350
U.S. Government obligations	38,817	39,381
Sub-total investments	43,794,325	40,998,137
Cash and cash equivalents held by investment managers	2,804,103	4,139,542
<b>TOTAL INVESTMENTS</b>	<b>\$ 46,598,428</b>	<b>\$ 45,137,679</b>

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, 2012 and 2011, the Foundation has uncalled commitments of \$390,379 and \$400,227, respectively.

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**2. INVESTMENTS (Continued)**

Alternative investments are comprised of the following at June 30, 2012 and 2011:

<u>Investment Type</u>	<u>Amount</u>		<u>Liquidity</u>
	<u>2012</u>	<u>2011</u>	
Domestic/U.S. Limited Partnerships	\$ 1,993,494	\$ 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	6,055,824	6,112,681	Last day of each quarter.
Hedge Funds	<u>7,965,519</u>	<u>7,950,264</u>	Last day of each quarter.
<b>ALTERNATIVE INVESTMENTS</b>	<b><u>\$16,014,837</u></b>	<b><u>\$17,327,143</u></b>	

Included in the investment balance at June 30, 2012 and 2011 are investments related to certain split-interest agreements in the amounts of \$1,269,270 and \$1,330,733, respectively.

The investment portfolio includes \$34,785,122 and \$30,840,509 of permanently restricted endowment investments at June 30, 2012 and 2011, respectively (see Note 17).

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, 2012 and 2011 consisted of the following:

	<u>2012</u>	<u>2011</u>
Interest and dividends	\$ 1,345,097	\$ 457,558
Unrealized (loss) gain	(2,576,601)	6,244,469
Realized gains (including realized gain on sale of debt financed property in the amount of \$1,984,368 in 2012)	<u>2,471,263</u>	<u>49,767</u>
Total investment return	1,239,759	6,751,794
Less: Investment income used for operations	<u>(2,117,275)</u>	<u>(1,983,546)</u>
<b>NET INVESTMENT RETURN</b>	<b><u>\$ (877,516)</u></b>	<b><u>\$ 4,768,248</u></b>



**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**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, 2012 and 2011, respectively:

	<b>2012</b>	<b>2011</b>
Federal receivables	\$ 1,106,994	\$ 1,355,431
Non-Federal receivables	91,012	182,098
Total accounts receivable	1,198,006	1,537,529
Less: Allowance for doubtful accounts	(2,064)	(16,619)
<b>NET ACCOUNTS RECEIVABLE</b>	<b>\$ 1,195,942</b>	<b>\$ 1,520,910</b>

**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, 2013. Only monthly payments of interest are to be made by the Tribe until maturity. The amounts outstanding at June 30, 2012 and 2011 were \$102,900 and \$103,000, respectively.

**5. PLEDGES RECEIVABLE**

As of June 30, 2012 and 2011, contributors to the Foundation have made written promises to give totaling \$18,236,867 and \$9,610,909, 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, 2012 and 2011:

	<b>2012</b>	<b>2011</b>
Less than one year	\$ 4,860,561	\$ 1,136,379
One to five years	6,967,461	1,655,882
Beyond five years	6,408,845	6,818,648
Total pledges	18,236,867	9,610,909
Less: Discount to net present value	(2,963,493)	(2,797,446)
Less: Allowance for doubtful accounts	(179,837)	(95,090)
<b>NET PLEDGES RECEIVABLE</b>	<b>\$ 15,093,537</b>	<b>\$ 6,718,373</b>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Land	\$ 10,315,411	\$ 10,315,411
Building and improvements	15,836,188	15,205,015
Furniture and equipment	3,150,865	3,169,957
Boats	3,722,630	3,688,747
Vehicles	522,847	480,656
Construction in progress	498,919	146,779
Art	<u>17,000</u>	<u>17,000</u>
Total property and equipment	34,063,860	33,023,565
Less: Accumulated depreciation and amortization	<u>(13,423,553)</u>	<u>(12,803,230)</u>
<b>NET PROPERTY AND EQUIPMENT</b>	<b><u>\$ 20,640,307</u></b>	<b><u>\$ 20,220,335</u></b>

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, 2012 and 2011 (see Note 17).

Depreciation expense for the years ended June 30, 2012 and 2011 totaled \$840,796 and \$847,424, respectively. Of these amounts, \$539,296 and \$543,339 is included in occupancy expense, and \$301,500 and \$304,085 is included in depreciation and amortization expense in the accompanying Statement of Functional Expenses for the years ended June 30, 2012 and 2011, respectively.

7. NOTE PAYABLE

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

On April 18, 2012, the Foundation paid the note in full, as well as a discounted portion of interest due through maturity. If the note had continued through the original terms, the total obligation of the Foundation would have been \$750,000 representing \$567,731 in principal and \$182,269 in interest. The lender agreed to accept \$675,000 as final payment representing \$567,731 in principal and \$107,269 in interest.

As of June 30, 2012 and 2011, the outstanding principal of the note payable was \$0 and \$609,051, respectively.

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.

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

8. BONDS PAYABLE (Continued)

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, 2012 and 2011, deferred financing costs, net of accumulated amortization, totaled \$62,331 and \$67,751, respectively.

The bonds are secured by a letter of credit issued by Wells Fargo Bank in the amount of \$6,724,469. It matured on October 31, 2012, and was renewed until October 31, 2013. 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 are 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 ended June 30, 2012, the Foundation was not in compliance with the bond covenants. The Foundation received a waiver from the creditor. For the year ended June 30, 2011, the Foundation was in compliance with all bond covenants.

The Foundation has cash held in a bond sinking fund in the amounts of \$335,110 and \$331,201 for the years ending June 30, 2012 and 2011, respectively.

As of June 30, 2012 and 2011, the outstanding principal of the bond payable totaled \$6,620,000 and \$7,030,000, respectively.

Principal payments are due as follows:

<u>Year Ending June 30,</u>	
2013	\$ 425,000
2014	445,000
2015	465,000
2016	490,000
2017	510,000
Thereafter	<u>4,285,000</u>
<b>BONDS PAYABLE</b>	<b><u>\$ 6,620,000</u></b>

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**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.

The Foundation incurred total interest expense on the bonds of \$292,791 and \$309,291 for the years ended June 30, 2012 and 2011, 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, 2012 and 2011, the outstanding notional amount was \$6,620,000 and \$7,030,000, 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, 2012 and 2011, the swap had a negative fair value of \$1,276,494 and \$905,112, 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, 2012, 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.

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**10. TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets consisted of the following at June 30, 2012 and 2011:

	<b>2012</b>	<b>2011</b>
<b>Program Restricted:</b>		
Environmental Education	\$ 130,129	\$ 385,238
Environmental Protection and Restoration	4,113,985	1,760,334
Communications	337,801	2,500
Property and Equipment	4,558,141	250,495
Other	140,091	130,986
Total program restricted	9,280,147	2,529,553
<b>Time Restricted</b>	<b>5,955,905</b>	<b>6,579,956</b>
<b>TEMPORARILY RESTRICTED NET ASSETS</b>	<b>\$ 15,236,052</b>	<b>\$ 9,109,509</b>

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, 2012 and 2011 are as follows:

	<b>2012</b>	<b>2011</b>
With purpose restrictions	\$ 2,250,163	\$ 2,675,043
Time restriction	364,444	771,451
<b>ACCUMULATED ENDOWMENT EARNINGS INCLUDED IN TEMPORARILY RESTRICTED NET ASSETS</b>	<b>\$ 2,614,607</b>	<b>\$ 3,446,494</b>

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:

	<b>2012</b>	<b>2011</b>
<b>Donor Restrictions:</b>		
Environmental Education	\$ 1,186,174	\$ 1,113,931
Environmental Protection and Restoration	2,818,543	2,316,291
Communications	256,321	40,000
Property and Equipment	669,940	253,795
Other	289,551	74,131
Total donor restrictions	5,220,529	3,798,148
<b>Time Restricted</b>	<b>1,630,634</b>	<b>2,006,241</b>
<b>NET ASSETS RELEASED FROM RESTRICTIONS</b>	<b>\$ 6,851,163</b>	<b>\$ 5,804,389</b>

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**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.

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

<u>Year Ending June 30,</u>	
2013	\$ 186,280
2014	124,294
2015	<u>56,109</u>
<b>LEASE COMMITMENT</b>	<b>\$ <u>366,683</u></b>

Rent expense for the years ended June 30, 2012 and 2011 totaled \$226,871 and \$243,665, 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, 2012 and 2011, the Foundation made contributions in the amounts of \$351,398 and \$360,954, respectively.

**13. RELATED PARTY**

For the years ended June 30, 2012 and 2011, the Foundation received gross contributions and grants in the amounts of \$6,761,392 and \$3,669,914, respectively, from Trustees, Executive Management, and their associated companies. Net amounts due under pledges receivable from related parties totaled \$1,068,518 and \$215,995 as of June 30, 2012 and 2011, respectively. Net amounts due under accounts receivable from related parties totaled \$71,616 and \$266,326 as of June 30, 2012 and 2011, 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 2012. 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, 2012

#### 15. DONATED GOODS, SERVICES AND PROPERTY

During the years ended June 30, 2012 and 2011, 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 \$1,718,693 and \$1,817,972 have been included in revenue and expense for the years ended June 30, 2012 and 2011, respectively, which included \$1,477,600 and \$1,670,200 of in-kind public service announcements for the year ended June 30, 2012 and 2011, respectively. In addition, the Foundation was the beneficiary of donated property and equipment totaling \$140,062 and \$8,000 for the years ended June 30, 2012 and 2011, 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 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 used at June 30, 2012.

- *Equity securities* - 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. The fair values used are generally determined by the general partner or management of the entity and are based on appraisals or other estimates that require varying degrees of judgment. Inputs used in determining fair value may include the cost and recent activity concerning the underlying investments in the funds or partnerships.
- *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.
- *U.S. Government obligations* - Valued at the closing price reported on the active market in which the individual securities are traded.

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**16. FAIR VALUE MEASUREMENTS (Continued)**

- *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.

The tables below summarize, by level within the fair value hierarchy, the Foundation's investments as of June 30, 2012 and 2011:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<b>Total June 30, 2012</b>
<b>Assets:</b>				
Equity securities	\$ 21,159,255	\$ 871,753	\$ -	\$ 22,031,008
Partnerships/Alternative investments	-	-	16,014,837	16,014,837
Corporate bonds and other agencies	2,783,328	1,985	-	2,785,313
Beneficial interest in perpetual trust	-	2,924,350	-	2,924,350
U.S. Government obligations	38,817	-	-	38,817
Cash and cash equivalents held by investment managers	<u>2,804,103</u>	<u>-</u>	<u>-</u>	<u>2,804,103</u>
<b>Total Investments</b>	<b><u>\$ 26,785,503</u></b>	<b><u>\$ 3,798,088</u></b>	<b><u>\$ 16,014,837</u></b>	<b><u>\$ 46,598,428</u></b>

**Liability:**

<b>Interest Rate Swap Obligation</b>	<b><u>\$ -</u></b>	<b><u>\$ 1,276,494</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 1,276,494</u></b>
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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<b>Total June 30, 2011</b>
<b>Assets:</b>				
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>
<b>Total Investments</b>	<b><u>\$ 24,206,809</u></b>	<b><u>\$ 3,603,727</u></b>	<b><u>\$ 17,327,143</u></b>	<b><u>\$ 45,137,679</u></b>

**Liability:**

<b>Interest Rate Swap Obligation</b>	<b><u>\$ -</u></b>	<b><u>\$ 905,112</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 905,112</u></b>
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CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

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, 2012 and 2011:

	<u>Investments</u>
Beginning balance as of July 1, 2010	\$ 14,683,916
Unrealized and realized gains	1,970,498
Earned income	211,800
Purchases	<u>460,929</u>
<b>BALANCE AS OF JUNE 30, 2011</b>	<b>17,327,143</b>
Unrealized and realized gains	1,824,376
Earned income	254,939
Sales	<u>(3,391,621)</u>
<b>BALANCE AS OF JUNE 30, 2012</b>	<b><u>\$ 16,014,837</u></b>

The amount of total gains or losses included in net unrestricted net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date was a loss of \$345,639 for the year ended June 30, 2012 and a gain of \$1,891,533 for the year ended June 30, 2011.

17. ENDOWMENT

The Foundation's endowment consist 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. 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.)

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

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:

	<u>2012</u>	<u>2011</u>
Environmental Education	\$ 9,193,269	\$ 8,456,826
Environmental Protection and Restoration	12,521,322	8,574,325
Property and equipment	7,916,052	7,916,052
General operating	<u>14,142,625</u>	<u>14,136,048</u>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>	<b><u>\$ 43,773,268</u></b>	<b><u>\$ 39,083,251</u></b>

Permanently restricted net assets consists of the following:

	<u>2012</u>	<u>2011</u>
Investments	\$ 34,785,122	\$ 30,840,509
Property and equipment	8,155,524	8,155,524
Pledge receivables, net of discount	<u>832,622</u>	<u>87,218</u>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>	<b><u>\$ 43,773,268</u></b>	<b><u>\$ 39,083,251</u></b>

Endowment net asset composition by type of fund as of June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-Restricted Endowment Funds	\$ (2,455,586)	\$ 2,614,607	\$ 43,773,268	\$ 43,932,289
Board-Designated Endowment Funds	<u>747,715</u>	<u>-</u>	<u>-</u>	<u>747,715</u>
<b>TOTAL FUNDS</b>	<b><u>\$ (1,707,871)</u></b>	<b><u>\$ 2,614,607</u></b>	<b><u>\$ 43,773,268</u></b>	<b><u>\$ 44,680,004</u></b>

CHESAPEAKE BAY FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

17. ENDOWMENT (Continued)

Changes in endowment net assets for the year ended June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (383,859)	\$ 3,446,494	\$ 39,083,251	\$ 42,145,886
Interest and dividends	-	979,446	-	979,446
Net depreciation of investments	<u>(52,891)</u>	<u>(1,585,957)</u>	<u>-</u>	<u>(1,638,848)</u>
Total investment return	<u>(52,891)</u>	<u>(606,511)</u>	<u>-</u>	<u>(659,402)</u>
Contributions	-	-	4,690,017	4,690,017
Appropriation of endowment assets for expenditure	-	(1,496,497)	-	(1,496,497)
Other changes:				
Transfer of net assets	<u>(1,271,121)</u>	<u>1,271,121</u>	<u>-</u>	<u>-</u>
<b>ENDOWMENT NET ASSETS, END OF YEAR</b>	<b><u>\$ (1,707,871)</u></b>	<b><u>\$ 2,614,607</u></b>	<b><u>\$ 43,773,268</u></b>	<b><u>\$ 44,680,004</u></b>

Endowment net asset composition by type of fund as of June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Donor-Restricted Endowment Funds</b>	\$ (1,184,466)	\$ 3,446,494	\$ 39,083,251	\$ 41,345,279
Board-Designated Endowment Funds	<u>800,607</u>	<u>-</u>	<u>-</u>	<u>800,607</u>
<b>TOTAL FUNDS</b>	<b><u>\$ (383,859)</u></b>	<b><u>\$ 3,446,494</u></b>	<b><u>\$ 39,083,251</u></b>	<b><u>\$ 42,145,886</u></b>

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (2,715,772)	\$ 2,136,881	\$ 38,672,680	\$ 38,093,789
Interest and dividends	98,054	296,827	-	394,881
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>2,331,913</u>	<u>2,754,941</u>	<u>-</u>	<u>5,086,854</u>
Contributions	-	-	171,099	171,099
Appropriation of endowment assets for expenditure	<u>-</u>	<u>(1,445,328)</u>	<u>-</u>	<u>(1,445,328)</u>
Other changes:				
Transfer of net assets	<u>-</u>	<u>-</u>	<u>239,472</u>	<u>239,472</u>
<b>ENDOWMENT NET ASSETS, END OF YEAR</b>	<b><u>\$ (383,859)</u></b>	<b><u>\$ 3,446,494</u></b>	<b><u>\$ 39,083,251</u></b>	<b><u>\$ 42,145,886</u></b>

**CHESAPEAKE BAY FOUNDATION, INC.**

**NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012**

**17. ENDOWMENT (Continued)**

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

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 \$2,455,586 and \$1,184,466 as of June 30, 2012 and 2011, 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 10, 2012, the date the financial statements were issued.



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

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

We have audited the financial statements of the Chesapeake Bay Foundation, Inc. as of and for the year ended June 30, 2012, and have issued our report thereon dated December 10, 2012, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplemental information is presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

December 10, 2012

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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, 2012**

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, 2012.

**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, 2012**

**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