



**Financial Statements**

Year ended June 30, 2013

with

Report of Independent Auditors

## Report of Independent Auditors

To the Board of Directors of Baykeeper:

We have audited the accompanying financial statements of Baykeeper (a nonprofit organization), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities and changes in net assets, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

### Responsibility of Management for the Financial Statements

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

### Responsibility of the Auditors

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

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

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

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Baykeeper as of June 30, 2013 and 2012, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Wilson Markle Stuckey Hardesty & Bott, LLP  
April 28, 2014

**Baykeeper**  
 Statements of Financial Position  
 June 30, 2013 and 2012

|  | <u>2013</u>                   | <u>Restated<br/>(Note 11)<br/>2012</u> |
|--|-------------------------------|--|
| <b>Assets</b>                            |                               |  |
| Cash and cash equivalents – Unrestricted | \$ 297,668                    | \$ 546,892                             |
| Cash and cash equivalents – Restricted   | 101,937                       | 76,597                                 |
| Investments                              | 368,380                       | 361,929                                |
| Grants and contributions receivable      | 23,210                        | 14,900                                 |
| Settlements receivable – Current         | 74,714                        | 72,633                                 |
| Settlements receivable – Long-term       | 15,189                        | 68,152                                 |
| Accounts receivable                      | 23,072                        | 1,534                                  |
| Prepaid expenses – Litigation            | 80,215                        | 1,622                                  |
| Prepaid expenses – Other                 | 9,589                         | 11,409                                 |
| Property and equipment, net              | 7,389                         | 9,541                                  |
| Deposits                                 | <u>9,858</u>                  | <u>9,858</u>                           |
| <br>Total assets                         | <br><u><u>\$1,011,221</u></u> | <br><u><u>\$1,175,067</u></u>          |
| <br><b>Liabilities and Net Assets</b>    |                               |  |
| <b>Liabilities</b>                       |                               |  |
| Accounts payable and accrued expenses    | \$ 90,524                     | \$ 51,403                              |
| Due to NRDC                              | 3,861                         | 3,860                                  |
| Advances - Litigation                    | 50,000                        | –                                      |
| Deferred revenue                         | 16,894                        | 24,719                                 |
| Deferred rent                            | <u>1,498</u>                  | <u>2,686</u>                           |
| <br>Total liabilities                    | <br>162,777                   | <br>82,668                             |
| <br><b>Net assets</b>                    |                               |  |
| <b>Unrestricted</b>                      |                               |  |
| Undesignated                             | 327,098                       | 600,892                                |
| Board-designated                         | <u>364,253</u>                | <u>359,104</u>                         |
| <br>Total unrestricted                   | <br>691,351                   | <br>959,996                            |
| <br>Temporarily restricted               | <br><u>157,093</u>            | <br><u>132,403</u>                     |
| <br>Total net assets                     | <br><u><u>848,444</u></u>     | <br><u><u>1,092,399</u></u>            |
| <br>Total liabilities and net assets     | <br><u><u>\$1,011,221</u></u> | <br><u><u>\$1,175,067</u></u>          |

See accompanying notes.

**Baykeeper**  
**Statements of Activities and Changes in Net Assets**  
**Years ended June 30, 2013 and 2012**

|                               |              |                           |             | Restated (Note 11) |                           |             |
|-------------------------------|--------------|---------------------------|-------------|--------------------|---------------------------|-------------|
|                               | Unrestricted | Temporarily<br>restricted | 2013 Totals | Unrestricted       | Temporarily<br>restricted | 2012 Totals |
| Support and revenue           |              |                           |             |                    |                           |             |
| Contributions                 | \$ 517,308   | \$ 49,327                 | \$ 566,635  | \$ 456,386         | \$ 71,342                 | \$ 527,728  |
| In-kind                       | 830,902      | -                         | 830,902     | ( 534,133)         | -                         | ( 534,133)  |
| Fee and cost recovery         | 153,075      | -                         | 153,075     | 1,514,742          | -                         | 1,514,742   |
| Investment, net               | 34,711       | 13                        | 34,724      | 4,343              | 45                        | 4,388       |
| Other                         | 6,591        | -                         | 6,591       | 16,287             | -                         | 16,287      |
| Net assets reclassified       | 24,650       | ( 24,650)                 | -           | 93,958             | ( 93,958)                 | -           |
| Total support and revenue     | 1,567,237    | 24,690                    | 1,591,927   | 1,551,583          | ( 22,571)                 | 1,529,012   |
| Expenses                      |              |                           |             |                    |                           |             |
| Program services              | 1,550,041    | -                         | 1,550,041   | 1,317,383          | -                         | 1,317,383   |
| Management and general        | 111,378      | -                         | 111,378     | 89,086             | -                         | 89,086      |
| Fundraising                   | 174,463      | -                         | 174,463     | 140,951            | -                         | 140,951     |
| Total expenses                | 1,835,882    | -                         | 1,835,882   | 1,547,420          | -                         | 1,547,420   |
| Changes in net assets         | ( 268,645)   | 24,690                    | ( 243,955)  | 4,163              | ( 22,571)                 | ( 18,408)   |
| Net assets, beginning of year | 959,996      | 132,403                   | 1,092,399   | 955,833            | 154,974                   | 1,110,807   |
| Net assets, end of year       | \$ 691,351   | \$157,093                 | \$ 848,444  | \$ 959,996         | \$132,403                 | \$1,092,399 |

See accompanying notes.

**Baykeeper**  
 Statements of Functional Expenses  
 Years ended June 30, 2013 and 2012

| Expenses                              | Program services   | Supporting services    |                  | 2013 Totals        |
|---------------------------------------|--------------------|------------------------|------------------|--------------------|
|                                       |                    | Management and general | Fundraising      |                    |
| Salaries                              | \$ 477,654         | \$ 41,431              | \$100,320        | \$ 619,405         |
| Payroll taxes                         | 36,964             | 2,380                  | 7,252            | 46,596             |
| Employee benefits                     | 80,077             | 8,347                  | 17,207           | 105,631            |
| Bay patrol                            | 9,825              | –                      | –                | 9,825              |
| Meetings and events                   | 8,727              | 13,754                 | 11,958           | 34,439             |
| Information technology                | 3,284              | 1,191                  | 6,168            | 10,643             |
| Insurance                             | 3,684              | 2,214                  | 723              | 6,621              |
| Occupancy                             | 48,001             | 3,091                  | 9,417            | 60,509             |
| Operating                             | 13,312             | 4,989                  | 1,836            | 20,137             |
| Professional services                 |                    |                        |                  |                    |
| Accounting                            | –                  | 21,350                 | –                | 21,350             |
| Legal – Environmental law enforcement | 812,676            | –                      | –                | 812,676            |
| Scientific and technical              | 18,284             | 10                     | 31               | 18,325             |
| Other                                 | 26,317             | 10,155                 | 11,172           | 47,644             |
| Publications and outreach             | 8,314              | 2,278                  | 7,806            | 18,398             |
| Depreciation                          | 2,922              | 188                    | 573              | 3,683              |
| <b>Total expenses</b>                 | <b>\$1,550,041</b> | <b>\$111,378</b>       | <b>\$174,463</b> | <b>\$1,835,882</b> |

| Expenses                              | Program services   | Supporting services    |                  | 2012 Totals        |
|---------------------------------------|--------------------|------------------------|------------------|--------------------|
|                                       |                    | Management and general | Fundraising      |                    |
| Salaries                              | \$ 367,355         | \$41,024               | \$ 70,488        | \$ 478,867         |
| Payroll taxes                         | 29,143             | 2,174                  | 5,192            | 36,509             |
| Employee benefits                     | 72,371             | 5,398                  | 12,893           | 90,662             |
| Bay patrol                            | 20,222             | –                      | –                | 20,222             |
| Meetings and events                   | 3,889              | 4,241                  | 10,128           | 18,258             |
| Information technology                | 1,949              | 127                    | 323              | 2,399              |
| Insurance                             | 3,546              | 3,523                  | 632              | 7,701              |
| Occupancy                             | 48,121             | 3,589                  | 8,573            | 60,283             |
| Operating                             | 16,157             | 6,835                  | 3,321            | 26,313             |
| Professional services                 |                    |                        |                  |                    |
| Accounting                            | –                  | 21,150                 | –                | 21,150             |
| Legal – Environmental law enforcement | 336,059            | –                      | –                | 336,059            |
| Scientific and technical              | 370,270            | –                      | 1,750            | 372,020            |
| Other                                 | 33,911             | –                      | 12,258           | 46,169             |
| Publications and outreach             | 4,666              | 705                    | 14,739           | 20,110             |
| Travel                                | 5,546              | 137                    | 217              | 5,900              |
| Depreciation                          | 4,178              | 183                    | 437              | 4,798              |
| <b>Total expenses</b>                 | <b>\$1,317,383</b> | <b>\$89,086</b>        | <b>\$140,951</b> | <b>\$1,547,420</b> |

See accompanying notes.

**Baykeeper**  
**Statements of Cash Flows**  
**Years ended June 30, 2013 and 2012**

|  | <u>2013</u>             | <u>Restated<br/>(Note 11)<br/>2012</u> |
|--|-------------------------|--|
| Cash flows from operating activities   |                         |  |
| Change in net assets   | (\$243,955)             | (\$ 18,408)                            |
| Adjustments to reconcile change in net assets with cash flows provided by operating activities |                         |  |
| Realized (gains) losses and unrealized (appreciation) depreciation of investments              | ( 28,098)               | 2,198                                  |
| Contributions of investments   | ( 1,188)                | ( 1,283)                               |
| Depreciation   | 3,683                   | 4,798                                  |
| Changes in assets and liabilities  |                         |  |
| Grants and contributions receivable  | ( 8,310)                | ( 8,085)                               |
| Settlements receivable   | 50,882                  | ( 101,267)                             |
| Accounts receivable  | ( 21,538)               | ( 1,534)                               |
| Prepaid expenses – Litigation  | ( 78,593)               | 466,733                                |
| Prepaid expenses – Other   | 1,820                   | 414                                    |
| Attorney-client trust accounts   | –                       | 227,782                                |
| Accounts payable and accrued expenses  | 39,121                  | ( 300,998)                             |
| Deferred revenue   | ( 7,825)                | ( 706)                                 |
| Deferred rent  | ( 1,188)                | 1,520                                  |
| Net cash provided (used) by operating activities   | ( 295,189)              | 271,164                                |
| Cash flows from investing activities   |                         |  |
| Purchases of investments   | ( 34,754)               | ( 1,472)                               |
| Proceeds from sale of investments  | 57,589                  | –                                      |
| Purchases of property and equipment  | ( 1,531)                | ( 2,531)                               |
| Net change in due to NRDC  | <u>1</u>                | <u>2</u>                               |
| Net cash provided (used) by investing activities   | 21,305                  | ( 4,001)                               |
| Cash flows from financing activities   |                         |  |
| Advances - Litigation  | <u>50,000</u>           | <u>–</u>                               |
| Net cash provided by financing activities  | <u>50,000</u>           | <u>–</u>                               |
| Net change in cash and cash equivalents  | ( 273,884)              | 267,163                                |
| Cash and cash equivalents, beginning of year   | <u>623,489</u>          | <u>356,326</u>                         |
| Cash and cash equivalents, end of year   | <u><u>\$399,605</u></u> | <u><u>\$623,489</u></u>                |

See accompanying notes.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 1 – Basis of presentation**

Basis of presentation

The mission of San Francisco Baykeeper (Baykeeper) is to protect and restore the water quality and habitat of San Francisco Bay (Bay). For 25 years, Baykeeper has worked to address the greatest threats to the health of the Bay in order to protect wildlife, the ecosystem and Bay Area communities.

The Bay is part of the largest estuarine system on the Pacific Coast of the Americas and one of the most ecologically productive water bodies in the world. Open water habitats, intertidal mudflats, rocky shores, salt ponds, marshes and shaded creek habitats all come together to form the iconic Bay that defines the character and community of the Bay Area.

A diverse wildlife community has historically thrived in and around the Bay and is beginning to flourish again. The Bay provides a home for 130 fish species and a nursery for ocean-going herring, sturgeon, salmon and Dungeness crab. Millions of migratory shorebirds using the Pacific Flyway depend on the Bay as a resting spot. Twenty-two threatened or endangered species, including the Snowy plover and the mission blue butterfly, live in the watershed of the Bay. Hundreds of native rare or endemic plants grow in the wide variety of environmental conditions unique to the Bay and surrounding landscapes.

Seven million people, 1,300 industrial facilities, 100 cities, four major ports and massive oil refineries also surround the Bay. Every day, toxic pollution from the urban and industrial landscape flows into the Bay, threatening people and wildlife. Aging sewer infrastructures release raw and undertreated sewage into local creeks and the Bay each winter and rain washes pollution from industrial sites, roadways and pesticide-laden landscapes directly into waterways with no treatment. Meanwhile, the global energy economy feeds the refineries and elevates the risk of oil spills in the Bay.

Clean water laws and regulations intended to protect the health of the Bay and its tributaries are not strong enough or enforced consistently. That is why Baykeeper exists. Using advocacy, science and legal action, Baykeeper strengthens clean water laws and regulations to rein in Bay pollution and enforces the Clean Water Act to hold polluters accountable.

As the sole nonprofit organization dedicated to protecting the Bay from pollution, Baykeeper has a tightly focused mission. The small, highly skilled staff of Baykeeper conducts research, water quality monitoring and on-the-water patrols to identify the sources of pollution most damaging to the Bay and key habitat. The staff of Baykeeper evaluates where there is the greatest need and where it can target advocacy to have the greatest impact. The science and legal staff of Baykeeper work together to develop the most effective strategies for pollution cleanup.

**Baykeeper**  
**Notes to Financial Statements**  
**June 30, 2013**

**Note 1 – Basis of presentation (continued)**

Baykeeper engages in advocacy and public education, pushes government agencies to do their job to safeguard and restore the Bay and brings strategic lawsuits under the Clean Water Act to compel polluters to stop contaminating the waters and wetlands that belong to all.

Baykeeper incorporated as a nonprofit, public benefit corporation in California on January 23, 1987, as the San Francisco Bay-Delta Preservation Association, and became Baykeeper in May 1989, the fourth “Waterkeeper” organization in the country. Along with Robert F. Kennedy, Jr. and other leaders, Baykeeper helped found an international network of on-the-water clean water activists to protect local waterways. There are now more than 200 related groups around the world. Baykeeper holds the “Baykeeper” trademark and licenses its use by other organizations. To avoid confusion, Baykeeper operates primarily under the name San Francisco Baykeeper.

**Note 2 – Summary of significant accounting policies**

Basis of accounting

Baykeeper prepares its financial statements using accounting principles generally accepted in the United States of America (US-GAAP). Baykeeper records revenues when earned and expenses when incurring the related obligations.

Fair value

Baykeeper uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets and have the highest priority. Level 2 inputs consist of observable inputs other than quoted prices for identical assets. Level 3 inputs consist of unobservable inputs that reflect internal judgments and have the lowest priority. Baykeeper uses appropriate valuation techniques based on the available inputs to measure fair value. When available, Baykeeper measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. Baykeeper only uses Level 3 inputs when Level 1 or Level 2 inputs are not available.

Baykeeper values contributions initially at fair value when promised. Baykeeper only revalues debt and marketable equity securities at least as often as it presents financial statements. For contributions valued initially at fair value but not revalued, Baykeeper treats the initial fair value as cost in subsequent financial statements.

The management of Baykeeper estimates that the aggregate net fair value of financial instruments recognized (including receivable, payables and accrued expenses) approximates their car-



**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

rying value, as such financial instruments are short-term in nature or bear interest at current market rates.

Cash and cash equivalents

Cash and cash equivalents consist of amounts on hand and on deposit with a commercial bank, available within 90 days of demand. The carrying amount of cash approximates fair value due to its short-term nature.

Investments

Investments (Note 3) consist principally of units of pooled investment funds (PIFs) of community foundations and cash held by one registered investment company. Baykeeper records PIFs at their contract value. Contract value represents the amount Baykeeper would realize upon sale, transfer, exchange or liquidation of the investment when transacted with the investment custodians. Contract value of the units of the PIFs is the Baykeeper share of the fair value of the underlying investments, determined by the community foundations, net of certain custodial and administrative fees.

Baykeeper records interest, dividends, gains, losses and changes in contract value (unrealized appreciation and depreciation) as net investment income, but not net of custodial and administrative fees.

The PIFs of the community foundations are subject to variance power under various agreements. The boards of trustees of the community foundations shall have the power to modify any restriction or condition on the distribution of funds for any specified charitable purposes or to a specified organization, if, in the sole judgment of the boards of trustees, such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment or inconsistent with the needs of the community served by the community foundation.

Receivables

Receivables (Note 4) consist principally of amounts due from governmental and corporate entities related to compliance activities and from corporations, foundations and individuals as contributions. Baykeeper initially records receivables at fair value. Baykeeper estimates the initial fair value of receivables as the estimated present value of expected future cash flows, taking into consideration risk-free interest rates and expected collection timing and risks. These are Level 2 (income) and Level 3 (income) inputs. Baykeeper records a discount representing the difference between the future cash flows promised by the defendant or donor and the estimated present value of the expected future cash flows. Baykeeper accretes the discount, using the interest method and based on actual collections, to fee and cost recovery and contributions, respectively.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

Allowance for uncollectible receivables

Baykeeper uses the allowance method to estimate any uncollectible receivables. Under this method, Baykeeper reviews all receivables, and estimates, based on aging, debtor history and other information, an allowance. When Baykeeper exhausts all attempts to collect specific receivables or the debtor discharges the receivable in bankruptcy, Baykeeper writes off the receivable against the estimated allowance. As of June 30, 2013 and 2012, the management of Baykeeper estimated that any allowance for uncollectible receivables was not material to the financial position of Baykeeper.

Property and equipment

Property and equipment consist of furniture, office, computer, boat and laboratory equipment and leasehold improvements. Baykeeper records property and equipment at cost or initially at fair value for contributed items. Baykeeper bases the initial fair value of contributed property and equipment on comparable sales of identical or similar items in markets available to Baykeeper, which is a Level 2 (market) input. Baykeeper expenses property and equipment with a cost or fair value under \$500 and the costs of maintenance and repairs that do not improve or extend the lives of the property and equipment. Baykeeper computes depreciation using the straight-line method over the estimated useful lives of the property and equipment of five years or the shorter remaining lease term for leasehold improvements.

Prepaid expenses – Litigation and Compliance

Baykeeper contracts with various attorneys, under Attorney Retention and Co-Counseling or similar Agreements (Retainer), to assist Baykeeper to compel governmental agencies and corporations to comply with various laws and regulations that protect the health of the Bay and its habitats (Litigation). Generally, contracted Litigation attorneys work on a contingency fee basis; i.e., the contracted Litigation attorneys only receive legal fees based on successful Litigation resulting in a settlement or Court ruling that includes payments for legal fees.

When represented by outside counsel on a contingency fee basis, Baykeeper agrees to be responsible for expert, consultant and other Litigation costs that are necessary to carry out the Litigation.

Baykeeper may pursue Litigation internally, without contracting with outside counsel. Under those circumstances, Baykeeper capitalizes all direct costs of Litigation, except staff salaries. Baykeeper expenses capitalized Litigation costs upon resolution of the case and records any related recovery as revenue.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

Successful Litigation against governmental agencies and corporations (Defendant) under federal and state environmental laws usually results in Settlement Agreements, Consent Decrees or similar arrangements (Settlement). Settlements generally require the Defendant to take corrective actions at their own expense; perform or contribute to an environmental mitigation project (not conducted by Baykeeper); and reimburse Baykeeper for the direct costs of bringing the Litigation, including legal fees (internal and external). Baykeeper records revenue for Settlement funds received that reimburse Baykeeper for the direct costs of bringing the Litigation.

In addition, Defendants generally agree to provide funds to enable Baykeeper to monitor compliance by the Defendant with the Settlement (Compliance). Compliance awards represent a negotiated estimate by Baykeeper and the Defendant of any remaining Litigation and Settlement costs and the future costs Baykeeper will incur to monitor Compliance. When Compliance monitoring by Baykeeper is optional, Baykeeper recognizes revenue from Compliance awards immediately. When Compliance monitoring by Baykeeper is required, Baykeeper defers recognition of revenue from Compliance awards over the Compliance period (Note 11).

Advances – Litigation

One nonprofit organization advanced Baykeeper amounts to pursue and pay some costs of certain Litigation. Outstanding advances do not bear interest and there is no fixed maturity date. Upon successful Litigation resulting in an award to Baykeeper that covers its costs of Litigation, Baykeeper will repay the nonprofit organization. If Litigation is unsuccessful or does not result in an award that covers the costs of Litigation, then the nonprofit organization will forgive unpaid advances. The management of Baykeeper believes that it is at least possible that it will succeed with Litigation. Accordingly, Baykeeper treats the outstanding advances as a loan until Litigation partially funded by the nonprofit organization proves to be unsuccessful or will not result in an award that covers the costs of Litigation, at which time; Baykeeper will reclassify the outstanding advances as contribution support.

Net assets

Net assets include cumulative unrestricted, temporarily restricted and permanently restricted net assets, net of cumulative expenses. Unrestricted net assets consist of revenue and support not restricted to a particular purpose or time by the donor, net of expenses. Temporarily restricted net assets consist of support restricted by the donor to a particular purpose or time. Temporarily restricted net assets become unrestricted net assets when Baykeeper meets the donor purpose or time restriction. Permanently restricted net assets consist of support restricted by the donor for Baykeeper to hold permanently, allowing for use of only the revenue generated by investing the support. As of June 30, 2013 and 2012, Baykeeper held no permanently restricted net assets.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

Contributed services

Attorneys, paralegals and others contribute substantial professional services to Baykeeper. Baykeeper determines the fair value of attorney fees by following judicial precedent to compare a proposed rate with the prevailing rate in the region for similar work performed by attorneys of comparable skill, experience and reputation, considering the novelty and complexity of the issues. In addition, Baykeeper uses the "Laffey Matrix" as a guide for calculating attorney rates. The D.C. Circuit Court approved the Laffey Matrix to provide objective guidance in assessing appropriate hourly rates depending on attorney experience. Baykeeper adjusts the Laffey Matrix by straight-lining annually the multi-year step increases and by the regional difference between attorney rates in the Washington, DC and San Francisco metropolitan areas. Finally, Baykeeper compares rates of other San Francisco attorneys who specialize in environmental litigation. The U.S. District Court for the Northern District of California, in *Baykeeper v. West Bay Sanitary District* 2011 U.S. Dist. LEXIS 138093, upheld this process and approved the rates of Baykeeper staff attorneys and outside counsel. Baykeeper records contributed professional services, including contingent fees, at fair value. This process involves principally Level 2 (market) inputs. Baykeeper bases the fair value of non-legal professional services on the cost of similar services from comparable purchases, which is a Level 3 (cost) input. Baykeeper only reports contributions of in-kind professional services when Baykeeper needs expertise or education not available to Baykeeper and Baykeeper would have paid for the professional services if donors had not contributed them.

In addition, Baykeeper reclassifies contributed legal services to program service revenue and paid legal services when Settlement funds pay contracted Litigation attorneys' contingent legal fees (Note 8).

Allocation of functional expenses

Baykeeper summarizes the costs of providing its program and supporting services on a functional basis. Accordingly, Baykeeper allocates certain indirect costs between program and support services based on annual estimates of time and usage.

Income taxes

In letters to Baykeeper, the Internal Revenue Service (IRS) and California Franchise Tax Board (FTB) stated that Baykeeper is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (IRC) and from California bank and corporation taxes under Section 23701(d) of the California Revenue and Taxation Code, respectively. In addition, Baykeeper qualifies for the charitable contribution deduction under IRC Section 170(b)(1)(A) and has been classified as a publicly supported organization as described in IRC Section 509(a)(1). Accordingly, donors are entitled to the maximum charitable contribution deduction allowed by law.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

The management of Baykeeper believes that no activities of Baykeeper jeopardized its exemption from income taxes, classification as a “public charity” or subjected it to unrelated business income or excise taxes. Accordingly, Baykeeper did not provide for income taxes.

The management of Baykeeper considers certain tax positions taken by Baykeeper. A tax position is a position taken in a previously filed tax return or a position the management of Baykeeper expects to take in a future tax return that figures in measuring current or deferred income tax assets and liabilities for interim or annual periods. A tax position can result in a permanent reduction in income taxes payable, a deferral of income taxes otherwise currently payable to future years or a change in the expected realizability of deferred tax assets. A tax position also encompasses, but is not limited to:

1. A decision not to file a tax return
2. An allocation or a shift of income between jurisdictions
3. The characterization of income or a decision to exclude reporting taxable income in a return
4. A decision to classify a transaction, entity or other position in a tax return as tax exempt
5. The status of an entity, including its status as a pass-through or tax-exempt entity

Evaluating a tax position requires the management of Baykeeper to determine, for each tax position, whether it is more likely than not that, upon examination by taxing authorities, such authorities will uphold the tax position and, for each more-likely-than-not tax position, determine the highest benefit with a more than 50% likelihood of realization upon ultimate settlement. Accordingly, it is possible that tax positions taken on tax returns and related amounts recognized herein could vary.

Baykeeper files tax returns with the IRS and FTB. Baykeeper recognizes interest and penalties related to income taxes and tax positions with interest expense and income tax expense, respectively. As of and for the years ended June 30, 2013 and 2012, interest and penalties related to income taxes and tax positions were not material. As of June 30, 2013, the management of Baykeeper believes that there are no tax positions of Baykeeper where it is reasonably possible that the total amount of unrecognized tax benefits will significantly increase or decrease within the period ending June 30, 2014. As of June 30, 2013, open tax periods subject to future examination by taxing authorities cover periods from July 1, 2009 through June 30, 2013.

Risks and concentrations

Cash and cash equivalents held by the commercial bank exceeded federal deposit insurance limits at various times during the years ended June 30, 2013 and 2012.

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 2 – Summary of significant accounting policies (continued)**

Investments are subject to credit and market risks. Credit risk is the probability that parties holding or supporting an investment will default or otherwise fail to perform. Market risk is the inherent change in the value of an investment due to changes in conditions.

As of June 30, 2013 and 2012, PIFs held by two community foundations, each holding at least 10%, totaled 99% and 99%, respectively, of total investments.

During the year ended June 30, 2013, in-kind services received from two law firms, each contributing more than 10%, totaled 90% of gross in-kind support and 41% of total expenses.

During the year ended June 30, 2012, in-kind services received from two law firms, each contributing more than 10%, totaled 76% of gross in-kind support and 18% of total expenses.

Use of estimates

The preparation of financial statements in conformity with US-GAAP requires the management of Baykeeper to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimated.

Subsequent events

The management of Baykeeper has evaluated subsequent events through April 28, 2014, the date these financial statements were available for issuance.

**Note 3 – Investments**

As of June 30, 2013 and 2012, investments totaled as follows:

|                      | <u>2013</u>      | <u>2012</u>      |
|----------------------|------------------|------------------|
| Cost                 |                  |                  |
| Cash                 | \$ 4,127         | \$ —             |
| Contract value       |                  |                  |
| PIFs                 | \$364,253        | 359,104          |
| Fair value – Level 1 |                  |                  |
| Stock                | —                | 2,714            |
| Mutual funds         | <u>—</u>         | <u>111</u>       |
| Total investments    | <u>\$368,380</u> | <u>\$361,929</u> |

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 3 – Investments (continued)**

During the years ended June 30, 2013 and 2012, net investment income totaled as follows:

|  | <u>2013</u>     | Restated<br><u>2012</u> |
|--|-----------------|-------------------------|
| Dividends and interest                 | \$ 6,625        | \$6,586                 |
| Realized loss                          | ( 209)          | –                       |
| Unrealized appreciation (depreciation) | <u>28,308</u>   | <u>( 2,198)</u>         |
| Net investment income                  | <u>\$34,724</u> | <u>\$4,388</u>          |

In addition, during the years ended June 30, 2013 and 2012, Baykeeper incurred custodial and administrative fees on its investments in PIFs, totaling \$2,559 and \$2,398, respectively, and included those amounts with operating expenses.

**Note 4 – Receivables**

As of June 30, 2013 and 2012, receivables totaled as follows:

|  | <u>2013</u>     | Restated<br><u>2012</u> |
|--|-----------------|-------------------------|
| BAE Systems San Francisco Ship Repair Inc.                                       | \$ 13,334       | \$ 26,667               |
| Berkeley Forge & Tool, Inc.  | 3,000           | –                       |
| City of Burlingame   | 20,000          | 25,000                  |
| California Waste Solutions, Inc.   | 3,300           | 15,600                  |
| Environmental Science Associates   | –               | 1,943                   |
| Hanson Aggregates Mid-Pacific, Inc. and LLC                                      | 8,000           | 8,000                   |
| Town of Hillsborough   | –               | 2,500                   |
| Lakeside Non-Ferrous Metals, Inc.  | 7,750           | –                       |
| City of San Bruno  | 30,000          | 60,000                  |
| County of San Mateo et. al.  | 3,000           | 4,500                   |
| U.S. Department of Commerce –<br>National Oceanic and Atmospheric Administration | 12,545          | –                       |
| Xstrata Recycling, Inc.  | 3,000           | –                       |
| Various individuals and others   | <u>33,737</u>   | <u>14,491</u>           |
| Receivables, gross   | 137,666         | 158,701                 |
| Discount on receivables  | <u>( 1,481)</u> | <u>( 1,482)</u>         |

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 4 – Receivables (continued)**

|                                    |                  |                  |
|------------------------------------|------------------|------------------|
| Receivables, net                   | 136,185          | 157,219          |
| Settlements receivable – Long-term | <u>15,189</u>    | <u>68,152</u>    |
| Receivables – Current              | <u>\$120,996</u> | <u>\$ 89,067</u> |

Receivables due during the years ending June 30, total as follows:

|      |           |
|------|-----------|
| 2014 | \$120,996 |
| 2015 | 6,160     |
| 2016 | 4,584     |
| 2017 | 4,445     |

**Note 5 – Property and equipment**

As of June 30, 2013 and 2012, property and equipment totaled as follows:

|                                 | <u>2013</u>     | <u>2012</u>     |
|---------------------------------|-----------------|-----------------|
| Furniture                       | \$ 5,830        | \$ 5,830        |
| Office equipment                | 4,262           | 3,516           |
| Computer equipment              | 15,760          | 14,975          |
| Boat and laboratory equipment   | 118,625         | 118,625         |
| Leasehold improvements          | <u>1,500</u>    | <u>1,500</u>    |
| Property and equipment, at cost | 145,977         | 144,446         |
| Accumulated depreciation        | ( 138,588)      | ( 134,905)      |
| Property and equipment, net     | <u>\$ 7,389</u> | <u>\$ 9,541</u> |

**Note 6 – Temporarily restricted net assets**

During the year ended June 30, 2013, temporarily restricted net assets reconciled as follows:

| <u>Activity</u>                             | <u>Beginning</u> | <u>Additions</u> | <u>Releases</u> | <u>Ending</u> |
|---|------------------|------------------|-----------------|---------------|
| Agricultural Pesticide and Mercury Programs | \$ 2,500         | \$ –             | \$2,500         | \$ –          |
| Bay patrols                                 | –                | 3,000            | 3,000           | –             |



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**Note 6 – Temporarily restricted net assets (continued)**

|                                      |                  |                 |                 |                  |
|--------------------------------------|------------------|-----------------|-----------------|------------------|
| Coastal Clean-Up Day                 | –                | 1,000           | 1,000           | –                |
| Dolphin Club Pier/Building (Note 11) | 72,736           | 25,340          | –               | 98,076           |
| Sacramento River Project             | 50,000           | –               | –               | 50,000           |
| Purchase sampling equipment          | 3,000            | –               | 3,000           | –                |
| Wetland restoration                  | –                | 20,000          | 10,983          | 9,017            |
| Time-restricted                      | <u>4,167</u>     | <u>–</u>        | <u>4,167</u>    | <u>–</u>         |
| Totals                               | <u>\$132,403</u> | <u>\$49,340</u> | <u>\$24,650</u> | <u>\$157,093</u> |

During the year ended June 30, 2012 (restated), temporarily restricted net assets reconciled as follows:

| <u>Activity</u>                               | <u>Beginning</u> | <u>Additions</u> | <u>Releases</u> | <u>Ending</u>    |
|---|------------------|------------------|-----------------|------------------|
| Agricultural Pesticide and Mercury Programs   | \$ –             | \$30,000         | \$27,500        | \$ 2,500         |
| Dolphin Club Pier/Building (Note 11)          | 69,349           | 3,387            | –               | 72,736           |
| Identifying pollution sources in West Oakland | –                | 10,000           | 10,000          | –                |
| Sacramento River Project                      | 50,000           | –                | –               | 50,000           |
| Purchase sampling equipment                   | –                | 3,000            | –               | 3,000            |
| Time-restricted                               | <u>35,625</u>    | <u>25,000</u>    | <u>56,458</u>   | <u>4,167</u>     |
| Totals  | <u>\$154,974</u> | <u>\$71,387</u>  | <u>\$93,958</u> | <u>\$132,403</u> |

**Note 7 – Endowment funds**

Baykeeper follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-205, “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 (UPMIFA) and Enhanced Disclosures for All Endowment Funds” and the related state of California version of the UPMIFA (CA-UPMIFA).

Endowment funds subject to FASB ASC 958-205 include all the endowment funds described below. As of June 30, 2013 and 2012, no endowment funds are subject to the CA-UPMIFA.

The endowment funds of Baykeeper consist of two individual funds held by separate community foundations. The endowment funds of Baykeeper include only funds designated by the Board

**Baykeeper**  
**Notes to Financial Statements**  
**June 30, 2013**

**Note 7 – Endowment funds (continued)**

of Directors to function as endowments. As required by US-GAAP, Baykeeper classifies and records net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, based on the existence or absence of donor-imposed restrictions.

The Board of Directors of Baykeeper has interpreted the CA-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. Because of this interpretation, Baykeeper classifies as permanently restricted net assets the original value of gifts contributed to the permanent endowment, the original value of subsequent gifts to the permanent endowment and 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 Baykeeper does not classify as permanently restricted net assets, Baykeeper classifies as temporarily restricted net assets until the Board of Directors of Baykeeper appropriates those amounts for expenditure by Baykeeper in a manner consistent with the standard of prudence prescribed by CA-UPMIFA. In accordance with CA-UPMIFA, Baykeeper considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of Baykeeper and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of Baykeeper
7. The investment policies of Baykeeper
8. The limitation under California state law of appropriations to seven percent of the fair value of the endowment funds

In addition, the endowment assets held by the community foundations are subject to the “Spending Rule” of the community foundations.

As of June 30, 2013, endowment funds totaled as follows:

|                  | <u>Unrestricted</u> | Temporarily<br><u>restricted</u> | Permanently<br><u>restricted</u> | <u>Totals</u>    |
|------------------|---------------------|----------------------------------|----------------------------------|------------------|
| Board designated | <u>\$364,253</u>    | <u>\$=</u>                       | <u>\$=</u>                       | <u>\$364,253</u> |

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Notes to Financial Statements  
June 30, 2013

Note 7 – Endowment funds (continued)

During the year ended June 30, 2013, endowment funds reconciled as follows:

|  | <u>Unrestricted</u> | Temporarily<br><u>restricted</u> | Permanently<br><u>restricted</u> | <u>Totals</u>    |
|--|---------------------|----------------------------------|----------------------------------|------------------|
| Beginning of year                                | \$359,104           | \$—                              | \$—                              | \$359,104        |
| Dividends and interest                           | 4,666               | —                                | —                                | 4,666            |
| Unrealized appreciation                          | 28,042              | —                                | —                                | 28,042           |
| Investment management and<br>administrative fees | ( 2,559)            | —                                | —                                | ( 2,559)         |
| Appropriations for expenditure                   | ( 25,000)           | —                                | —                                | ( 25,000)        |
| End of year                                      | <u>\$364,253</u>    | <u>\$—</u>                       | <u>\$—</u>                       | <u>\$364,253</u> |

As of June 30, 2012, endowment funds totaled as follows:

|                  | <u>Unrestricted</u> | Temporarily<br><u>restricted</u> | Permanently<br><u>restricted</u> | <u>Totals</u>    |
|------------------|---------------------|----------------------------------|----------------------------------|------------------|
| Board designated | <u>\$359,104</u>    | <u>\$—</u>                       | <u>\$—</u>                       | <u>\$359,104</u> |

During the year ended June 30, 2012, endowment funds reconciled as follows:

|  | <u>Unrestricted</u> | Temporarily<br><u>restricted</u> | Permanently<br><u>restricted</u> | <u>Totals</u>    |
|--|---------------------|----------------------------------|----------------------------------|------------------|
| Beginning of year                                | \$359,566           | \$—                              | \$—                              | \$359,566        |
| Dividends and interest                           | 3,779               | —                                | —                                | 3,779            |
| Unrealized depreciation                          | ( 1,843)            | —                                | —                                | ( 1,843)         |
| Investment management and<br>administrative fees | ( 2,398)            | —                                | —                                | ( 2,398)         |
| End of year                                      | <u>\$359,104</u>    | <u>\$—</u>                       | <u>\$—</u>                       | <u>\$359,104</u> |

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 CA-UPMIFA requires Baykeeper to retain as a fund of perpetual duration. In accordance with US-GAAP, Baykeeper records deficiencies of this nature in unrestricted net assets. Deficiencies may result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions and continued appropriation for programs that the Board of Directors deems prudent. There were no such deficiencies as of June 30, 2013 or 2012.

**Baykeeper**  
**Notes to Financial Statements**  
**June 30, 2013**

**Note 7 – Endowment funds (continued)**

Baykeeper 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 Baykeeper must hold in perpetuity or for donor-specified periods as well as board-designated funds.

Because Baykeeper invests all endowment assets with two community foundations, Baykeeper has adopted the investment policies of the two community foundations. Actual returns in any given year may vary from expected returns under the investment policies of the respective community foundations.

Because Baykeeper invests all endowment assets with two community foundations, Baykeeper has adopted the spending policies of the two community foundations. This is consistent with the 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.

Unrestricted (board designated) endowment funds are subject to redesignation at any time, including redesignation as other than endowment funds.

**Note 8 – In-kind contributions and recoveries**

During the years ended June 30, 2013 and 2012, in-kind contributions, net of recoveries (including prior years) from Settlements (Note 2), reconcile as follows:

|                                 | <u>2013</u>      | <u>2012</u>        |
|---------------------------------|------------------|--------------------|
| Contributed services            |                  |                    |
| Attorneys                       | \$800,595        | \$309,751          |
| Others                          | 34,628           | 48,891             |
| Contributed goods               |                  |                    |
| Fundraising events              | 10,372           | 8,428              |
| Outside attorney fee recoveries | ( 14,693)        | ( 901,203)         |
| In-kind contributions, net      | <u>\$830,902</u> | <u>(\$534,133)</u> |

**Baykeeper**  
Notes to Financial Statements  
June 30, 2013

**Note 9 – Retirement plan**

Baykeeper sponsors a defined contribution salary deferral plan under IRC section 401(k) for its eligible employees. Eligible employees may contribute up to 100% of their eligible salary to the plan, subject to limits imposed under the IRC. The plan allows, but does not require, Baykeeper to contribute. Except for a certain executive officer, during the years ended June 30, 2013 and 2012, Baykeeper contributed to eligible employees, based on 5% and 10%, respectively, of their eligible compensation, amounts totaling \$44,686 and \$39,053, respectively.

**Note 10 – Commitments and contingencies**

Baykeeper leases office space under an operating lease that expires January 31, 2015. The lease contains an automatic fixed amount escalation clause and option to renew for three years. Future minimum office space lease payments, for each of the years ending June 30, total as follows:

|      |          |
|------|----------|
| 2014 | \$63,954 |
| 2015 | 38,228   |

During the years ended June 30, 2013 and 2012, office space rent expense totaled \$60,283 and \$60,283, respectively.

**Note 11 – Change in an accounting principle and correction of an error**

Change in an accounting principle

During the year ended June 30, 2013, Baykeeper changed its method of accounting for certain Compliance awards and applied the change retrospectively. Baykeeper elected to recognize revenue from Compliance awards immediately when Compliance monitoring by Baykeeper is optional. Previously, whether Compliance monitoring by Baykeeper was optional or required, Baykeeper deferred recognition of revenue from Compliance awards over the Compliance period. The management of Baykeeper believes that Compliance awards, when Compliance monitoring by Baykeeper is optional, represent immediate revenue to Baykeeper. Accordingly, Baykeeper retrospectively adjusted certain amounts previously presented in its financial statements as of and for the year ended June 30, 2012 (below).

Correction of an error

During the year ended June 30, 2013, the management of Baykeeper evaluated agreements related to funds held for another entity and received from a governmental entity that previously held the funds for the other entity. Based on the evaluation, Baykeeper determined that the

**Baykeeper**  
**Notes to Financial Statements**  
**June 30, 2013**

**Note 11 – Change in an accounting principle and correction of an error (continued)**

governmental entity and the other entity granted Baykeeper variance power of the funds held for the other entity. Accordingly, Baykeeper corrected its previous classification of the funds held for the other entity from a liability due to the other entity to temporarily restricted net assets of Baykeeper and retrospectively adjusted certain amounts previously presented in its financial statements as of and for the year ended June 30, 2012 (below).

Amounts marked “P” relate principally to the change in an accounting principle, “E” correction of an error and “P/E” to both.

| <u>Financial statement component</u>             | <u>P/E</u> | <u>Herein</u> | <u>Previously</u> | <u>Difference</u> |
|--|------------|---------------|-------------------|-------------------|
| Asset: Grants and contributions receivable       | P          | \$ 14,900     | \$ 12,958         | \$ 1,942          |
| Asset: Settlements receivable – Long-term        | P          | 68,152        | 69,634            | ( 1,482)          |
| Asset: Accounts receivable                       | P          | 1,534         | 3,476             | ( 1,942)          |
| Liability: Accounts payable and accrued expenses | P          | 51,403        | 51,311            | 92                |
| Liability: Reserve                               | E          | 3,860         | 76,597            | ( 72,737)         |
| Liability: Deferred revenue                      | P          | 24,719        | 344,930           | ( 320,211)        |
| Net assets: Unrestricted, undesignated           | P          | 600,962       | 282,254           | 318,708           |
| Net assets: Temporarily restricted               | E          | 132,403       | 59,667            | 72,736            |
| Support and revenue: Total                       | P/E        | 1,529,012     | 1,428,032         | 100,980           |
| Expenses: Total                                  | P          | 1,547,420     | 1,547,327         | 93                |
| Change in net assets: Total                      | P/E        | ( 18,408)     | ( 119,295)        | 100,887           |
| Net change in cash and cash equivalents          | P          | 267,163       | 263,774           | 3,389             |