

Montalvo Association
Financial Statements
September 30, 2006

MONTALVO ASSOCIATION

FINANCIAL STATEMENTS SEPTEMBER 30, 2006

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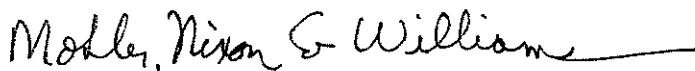
INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Trustees of Montalvo Association

We have audited the accompanying statement of financial position of Montalvo Association as of September 30, 2006, and the related statements of activities and changes in net assets, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of Montalvo Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Montalvo Association as of September 30, 2006, and the changes 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.



MOHLER, NIXON & WILLIAMS
Accountancy Corporation

Campbell, California
January 26, 2007

MONTALVO ASSOCIATION

STATEMENT OF FINANCIAL POSITION SEPTEMBER 30, 2006

Assets

Cash and cash equivalents	\$ 679,044
Other receivable	159,817
Grants receivable	317,500
Pledges receivable, net of allowance for doubtful accounts of \$29,000	612,188
Prepaid assets and other assets	251,926

Total current assets 2,020,475

Property and equipment, net	11,181,787
Long-term investments	3,014,306
Grants receivable, net of current portion	200,000
Pledges receivable, net of current portion	1,063,686

Total assets \$ 17,480,254

Liabilities and net assets

Note payable	\$ 170,300
Accounts payable and accrued expenses	650,821
Deferred revenue	876,617
Current portion, long-term debt	257,148

Total current liabilities 1,954,886

Long-term debt, net of current portion 451,953

Total liabilities 2,406,839

Unrestricted	13,025,785
Temporarily restricted	1,529,757
Permanently restricted	517,873

Total net assets 15,073,415

Total liabilities and net assets \$ 17,480,254

See notes to financial statements.

MONTALVO ASSOCIATION

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Public support and other revenue:				
Public support:				
Grants and contributions	\$ 205,975	\$ 496,875		\$ 702,850
Individuals	1,813,943	1,125,000	\$ 167,873	3,106,816
Corporate sponsorship	233,787			233,787
Special events	309,872			309,872
Total public support	2,563,577	1,621,875	167,873	4,353,325
Other revenue:				
Arts program	3,060,475			3,060,475
Rentals	658,363			658,363
Gain on investments, net	190,506			190,506
Dividend and interest income	100,784			100,784
Concessions and merchandise	296,641			296,641
Total other revenue	4,306,769			4,306,769
Net assets released from restrictions	1,019,372	(1,019,372)		-
Total public support and other revenue	7,889,718	602,503	167,873	8,660,094
Expenses:				
Program services	7,343,967			7,343,967
Supporting services:				
Management and general	674,188			674,188
Fund raising	846,070			846,070
Total support services	1,520,258			1,520,258
Total expenses	8,864,225			8,864,225
Increase (decrease) in net assets before other changes	(974,507)	602,503	167,873	(204,131)
Other changes:				
Property tax abatement	217,947			217,947
Increase (decrease) in net assets	(756,560)	602,503	167,873	13,816
Net assets at beginning of year	13,782,345	927,254	350,000	15,059,599
Net assets at end of year	\$ 13,025,785	\$ 1,529,757	\$ 517,873	\$ 15,073,415

See notes to financial statements.

MONTALVO ASSOCIATION

STATEMENT OF FUNCTIONAL EXPENSES FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Program services	Management and general	Fund raising	Total
Compensation and related expenses				
Compensation	\$ 1,672,934	\$ 346,017	\$ 409,687	\$ 2,428,638
Payroll taxes and employee benefits	280,136	67,320	62,528	409,984
Total compensation and related benefits	1,953,070	413,337	472,215	2,838,622
Artist fees / Hospitality	2,454,449		34,452	2,488,901
Cost of sales	218,747		37,190	255,937
Production costs (equipment rentals, lighting, sound, etc.)	490,711		7,070	497,781
Advertising and publicity	348,856	496	5,080	354,432
Consultants	56,817	87,512	18,858	163,187
Property tax	3,999			3,999
Transportation / Vehicles	130,958		965	131,923
Printing	114,550	768	68,342	183,660
Maintenance	201,635	7,701	11,320	220,656
Liability insurance	124,833	4,768	7,008	136,609
Cultivation / Hospitality	28,089	11,955	92,257	132,301
Utilities	114,294	4,365	6,416	125,075
Postage	12,932	1,903	83,482	98,317
Venue rents	95,451			95,451
Professional fees	30,530	62,732		93,262
Supplies	82,825	550	2,461	85,836
Debt interest	70,791			70,791
Telephone	48,134	14,262	8,914	71,310
Public relations	39,693			39,693
Conferences / Training / Dues / Subscriptions	33,011	6,533	2,730	42,274
Travel	22,870	7,345	1,331	31,546
Office supplies	15,236	4,514	2,822	22,572
Unamortized discount			(36,906)	(36,906)
Miscellaneous / Bad debt	40,260	35	601	40,896
Repairs (major and minor)	27,358			27,358
Total expenses before depreciation	6,760,099	628,776	826,608	8,215,483
Depreciation	583,868	45,412	19,462	648,742
Total expenses	\$ 7,343,967	\$ 674,188	\$ 846,070	\$ 8,864,225
Functional expense percentage	82.52%	7.61%	9.87%	100%

See notes to financial statements.

MONTALVO ASSOCIATION

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED SEPTEMBER 30, 2006

Cash flows from operating activities:	
Increase in net assets	\$ 13,816
Adjustments to reconcile increase in net assets to net cash provided by operating activities:	
Depreciation	648,742
Net realized and unrealized gain on investments	(190,507)
Donated equipment	(43,178)
Changes in current assets and liabilities:	
Changes in grants receivable	469
Changes in pledges receivable	(608,233)
Changes in other receivables	95,186
Changes in interest receivable	97,842
Changes in prepaids and other assets	(57,516)
Changes in accounts payable and accrued expenses	(206,485)
Changes in deferred revenue	274,482
<hr/> Net cash provided by operating activities	<hr/> 24,618
Cash flows from investing activities:	
Capital expenditures	(640,495)
Purchases of investments	(1,222,775)
Sales of investments	1,807,238
<hr/> Net cash used by investing activities	<hr/> (56,032)
Cash flows from financing activities:	
Repayment of note payable and long-term debt	(466,470)
<hr/> Net cash used by financing activities	<hr/> (466,470)
Net increase in cash and cash equivalents	(497,884)
Cash and cash equivalents at beginning of year	1,176,928
<hr/> Cash and cash equivalents at end of year	<hr/> \$ 679,044
Supplemental cash flow information	
Interest paid during the year	\$ 70,791

See notes to financial statements.

MONTALVO ASSOCIATION

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2006

NOTE 1 - THE ASSOCIATION AND ITS SIGNIFICANT ACCOUNTING POLICIES

Montalvo Association (Montalvo or the Association) was established in 1952 in Saratoga, California, under the will of James D. Phelan, former United States Senator from California and Mayor of San Francisco, to manage the charitable trust created in 1930 for the preservation of Villa Montalvo and support of its arts programs. Montalvo's mission is to inspire a love of the arts in everyone through creation, education, and presentation in extraordinary ways and settings.

Summary of significant accounting policies - In accordance with Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*, the Association reports its financial position and operating activities in three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

- Unrestricted net assets include those assets over which the Board of Directors (the Board) has discretionary control in carrying out the operations of the Association. Under this category, the Association maintains an operating fund and a building fund plus any net assets designated by the Board for specific purposes. The Association has elected to report as an increase in unrestricted net assets any restricted revenue received in the current period for which the restrictions have been met in the current period.
- Temporarily restricted net assets include those assets that are subject to a donor restriction and for which the applicable restriction was not met as of the end of the current reporting period.
- Permanently restricted net assets include those assets that are subject to a non-expiring donor restriction, such as endowments.

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents - The Association considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. The majority of cash and cash equivalents consist of deposits with a bank in excess of federally insured limits.

Concentration of credit risk - Financial instruments that potentially subject the Association to concentration of credit risk consist principally of cash and cash equivalents, pledges receivable, grants receivable and investments. Cash and cash equivalents are deposited in local reputable financial institutions. The credit risk in the pledges receivable is mitigated by the fact that pledges are made by predominately local donors and are evaluated by the Association based on knowledge of the donors. Additionally, any pledges that are expected to be collected after one year have been discounted at a rate of 4% and are reflected in the financial statements at their net present value. The credit risk in investments is mitigated by the fact that the Association regularly reviews the investments and uses an outside investment manager.

Contributions-in-kind - Donated goods are recorded at their estimated value at the date of donation. Throughout the year, volunteers and the Montalvo Service Group contribute a substantial number of hours labor in support of cultural arts activities. However, such contributed services do not meet the criteria for recognition of contributed services contained in SFAS No. 116, *Accounting for Contributions Received and Contributions Made*, and, accordingly, are not reflected in the accompanying financial statements.

Contributions and pledges receivable - Contributions are recognized when the donor makes a promise that is in substance, an unconditional promise to give to the Association. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions.

When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

The Association uses the allowance method to reserve for uncollectible receivables. The allowance is based on prior years' experience and management's analysis of specific promises made by the donors. As of September 30, 2006, the Company has an allowance for doubtful accounts of \$29,000.

Grants - The Association receives grants from corporate and governmental sources. Corporate grants are generally received to underwrite performances and events of the Performing Arts Program, as well as for arts education, artists' residency and the visual arts at Montalvo.

Investments - The Association invests in marketable securities consisting of corporate bonds, equity securities, treasury bonds and money market funds. Investments are presented in the financial statements at fair market value. Dividends, interest income and realized and unrealized gains and losses from investments are credited directly to unrestricted net assets, unless restricted by the contributor.

Property and equipment - Property and equipment are stated at cost. Acquisitions of property and equipment in excess of \$5,000 are capitalized. Significant donated property and equipment are recorded at fair market value upon receipt. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, generally as follows:

	<u>Years</u>
Buildings and improvements	10 to 30
Furniture and equipment	3 to 10
Vehicles	5

Long-lived assets - The Association reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No such impairments have been identified to date.

Advertising - Advertising costs are expensed as incurred. Advertising expense for the year ended September 30, 2006 was approximately \$354,000.

Income taxes - The Association is exempt from federal and state income taxes under provisions of Section 501(c)(3) of the Internal Revenue Code and applicable state statutes and is not classified as a private foundation.

Deferred revenue - The Association received deposits during the year ended September 30, 2006 in advance for various rentals and performances. As of September 30, 2006, approximately \$877,000 had not been earned and has been recorded as deferred revenue.

Functional allocation of expenses - The costs of providing program and other activities have been summarized on a functional basis in the statement of activities and changes in net assets. Indirect expenses are allocated based upon estimated functional usage by time or other appropriate means. Accordingly, certain costs have been allocated among the program and support services benefited.

NOTE 2 - EMPLOYEE BENEFIT PLAN

During 2000, the Association established a defined contribution plan (the Plan) for all eligible employees who are age 18 years or above and have completed three months of service. The Association is allowed to make a discretionary contribution equal to 3% of all eligible employees' compensation. No contribution was made to the Plan for the year ended September 30, 2006.

NOTE 3 - PLEDGES AND GRANTS RECEIVABLE

Pledges and Grants receivable consisted of the following at September 30, 2006:

	<u>Pledges</u>	<u>Grants</u>	<u>Total</u>
Amounts due in:			
Less than one year	\$ 641,188	\$ 317,500	\$ 958,688
One to five years	<u>1,142,100</u>	<u>210,000</u>	<u>1,352,100</u>
Pledges and Grants receivable	1,783,288	527,500	2,310,788
Allowance for doubtful accounts	(29,000)		(29,000)
Unamortized discount	<u>(78,414)</u>	<u>(10,000)</u>	<u>(88,414)</u>
Pledges and Grants receivable, net	1,675,874	517,500	2,193,374
Current portion	<u>(612,188)</u>	<u>(317,500)</u>	<u>(929,688)</u>
Long-term pledges and Grants receivable	<u>\$1,063,686</u>	<u>\$ 200,000</u>	<u>\$ 1,263,686</u>

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at September 30, 2006:

Land	\$ 53,000
Land improvements	150,641
Gallery	450,171
Building improvements	3,856,976
Building improvements - East wing	534,755
Carriage house	1,173,524
Furniture and fixtures	239,217
Office equipment	487,307
Vehicles	71,116
Artists residency	8,550,697
Construction in progress	<u>65,741</u>
	15,633,145
Less: accumulated depreciation and amortization	<u>(4,451,358)</u>
	<u>\$11,181,787</u>

Property and equipment have been recorded at cost, or fair market value if donated, together with related depreciation expense. The Association's policy is to remove property and equipment from the accounts once they have been fully depreciated.

NOTE 5 - INVESTMENTS

Investments consisted of the following at September 30, 2006:

	<u>Market</u>	<u>Cost</u>	<u>Unrealized gains</u>
U.S. Treasury bonds and notes	\$ 587,971	\$ 586,909	\$ 1,062
Corporate bonds and notes	110,879	114,938	(4,059)
Equity securities	2,310,216	1,796,658	513,558
Mortgage backed securities	<u>5,240</u>	<u>5,151</u>	<u>89</u>
	<u>\$3,014,306</u>	<u>\$2,503,656</u>	<u>\$ 510,650</u>

No individual investment represents 10% or more of the total investment balance at September 30, 2006.

Investment income included in the statement of activities and changes in net assets for the year ended September 30, 2006 consists of the following:

Dividend and interest income	<u>\$ 100,784</u>
Net realized gains	212,776
Net unrealized loss	<u>(22,270)</u>
Net realized and unrealized gains on investments	<u>190,506</u>
Total investment income	<u>\$ 291,290</u>

There was approximately \$31,000 in investment fees paid for the year ended September 30, 2006.

NOTE 6 - FINANCING ARRANGEMENTS

Long-term debt - The Association is in the third year of its five-year bank term loan with monthly principle payments of \$21,429 plus interest at a rate equal to the bank's base rate minus 0.5%. The interest rate as of September 30, 2006 was 7.75%. The balance outstanding as of September 30, 2006 was approximately \$709,000 and the loan matures June 16, 2009 with the balance unpaid due at that time. This term loan was entered into for the financing of construction activities related to the Artists Residency Complex. Collateral for this note is the Association's personal property and excludes real property and a specified Montalvo investment account. The loan agreement contains certain financial covenants.

Borrowing from the Silicon Valley Arts Fund - The Association has borrowed funds from the Silicon Valley Arts Fund, due June 30 of every year, renewable annually, with no interest. This loan was made from the Association's allocation of undisbursed funds held in trust for Montalvo by the Silicon Valley Arts Fund, as described in Note 11. The balance due at September 30, 2006 is \$170,300.

Future principal payments are approximately as follows on the bank note:

<u>Years ending September 30,</u>	
2007	\$ 257,148
2008	257,148
2009	<u>194,805</u>
	709,101
Less current portion	<u>257,148</u>
Long term debt	<u>\$ 451,953</u>

NOTE 7 - MONTALVO SERVICE GROUP

The Montalvo Service Group (the Group) was established in 1954. Its primary purpose is to provide financial assistance to the Association. The Group is an internal part of the Association, but operated under separate bylaws as a committee of the Association. During the fiscal year ended September 30, 2006, cash aggregating approximately \$15,000 was transferred by the Group to the Association.

NOTE 8 - UNRESTRICTED NET ASSETS

Board designated funds - Board designated funds represent resources currently available for use, but expendable only for those operating purposes specified by the Board. Designated funds consist of the following at September 30, 2006:

Montalvo Service Group	\$ 48,723
Uncommitted	1,465,275
Committed - roof and trellis	80,000
Emergency	<u>250,000</u>
	<u>\$1,843,998</u>

Expended funds - The following unrestricted net assets are expended at September 30, 2006:

Purchased and donated assets, net of accumulated depreciation	<u>\$11,181,787</u>
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NOTE 9 - TEMPORARILY RESTRICTED NET ASSETS

During 1995, the Association began a Capital campaign to raise funds to make significant renovations to the Carriage House Theater and to build new cottages for the Artists Residency Program. In 2006, the campaign was completed and at September 30, 2006, there were \$843,288 in pledges receivable. The Association has started a new campaign called the "New Ventures Fund" to be used over the next three years. The New Ventures Fund goal is \$6.3 million and is a time-restricted fund to be released equally over the next three fiscal years. As of September 30, 2006, \$600,000 in pledges have been received.

Temporarily restricted net assets are available for the following purposes at September 30, 2006:

New Ventures Fund - Operating	\$ 600,000
Rees - Hewlett - LAP Operating	450,000
James Irvine Grant - LAP Capacity Building	267,000
Hewlett Grant - Operating	52,500
Sobrato Foundation - Development match	25,000
Margolis - 2007 Classical support	25,000
ScanDisk - Performance support Carriage House	21,875
Community Foundation - Organization Effectiveness	20,000
Other (individually less than \$20,000)	<u>68,382</u>
	<u>\$ 1,529,757</u>

Net assets released from restrictions by incurring expenses satisfying the restricted purpose or by expiration of time are as follows for the year ended September 30, 2006:

Donor restrictions met:

Trellis restoration	\$ 393,705
Rees - Baccardo LAP Operating	125,000
James Irvine Grant - LAP Capacity Building	133,000
Artist Residency Capital Campaign	126,305
Hewlett Foundation - LAP Operating	100,000
Hewlett Foundation - General Operating	105,000
Other (individually less than \$20,000)	<u>36,362</u>
	<u>\$ 1,019,372</u>

NOTE 10 - PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of endowment fund investments that represent the principal amounts of gifts and bequests accepted with the donor stipulation that the principal be maintained intact in perpetuity or for a specified period, with only the income to be utilized for operations. The endowment funds were made up of the following at September 30, 2006:

Phelan Trust	\$ 268,653
Taylor	67,873
Doyle	100,000
Residency scholarship	48,615
Hinman	11,758
Gilbert	10,974
Burbank	<u>10,000</u>
	<u>\$ 517,873</u>

NOTE 11 - SILICON VALLEY ARTS FUND - VILLA MONTALVO

The Association will be the recipient of endowment fund earnings from the Silicon Valley Arts Fund (SVAF) held in trust by the Community Foundation of Santa Clara County (the Foundation). The trust was established with funds from the David and Lucile Packard Foundation, the William and Flora Hewlett Foundation, the City of San Jose and other foundations, individuals, corporations and public agencies.

The SVAF is holding approximately \$16,497 of undisbursed funds for the Association as of September 30, 2006, not including the loan of \$170,300 to the Association as described in Note 6. Distributions of approximately \$768 were received from SVAF for the year ended September 30, 2006.

The funds are owned and managed under the control of the Foundation, with investment income accruing to the benefit of the Association. Should the Association be disbanded, lose its non-profit status or cease to render services to the public on an effective basis, such funds would be redirected to other arts organizations within the SVAF.

NOTE 12 - RELATED PARTY TRANSACTION

The Association's volunteer Board members are active in both the oversight of the Organization and its various fund raising events. Contributions received from the Board members were approximately \$646,000 for the year ended September 30, 2006. In addition, the Association awarded a \$674,000 construction contract to a Board Member.