

**Montalvo Association**  
**(A California Nonprofit Public Benefit Corporation)**

Financial Statements

For the Year Ended  
September 30, 2014 With Comparative Totals  
For the Year Ended September 30, 2013



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## INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of  
Montalvo Association  
Saratoga, California

We have audited the accompanying financial statements of Montalvo Association (a California nonprofit public benefit corporation) which comprise the statement of financial position as of September 30, 2014, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

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


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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montalvo Association as of September 30, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Report on Summarized Comparative Information**

We have previously audited Montalvo Association's 2013 financial statements, and our report dated January 24, 2014 expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.



Armanino<sup>LLP</sup>  
San Ramon, California

January 26, 2015

MONTALVO ASSOCIATION  
Statement of Financial Position  
September 30, 2014  
(With Comparative Totals for 2013)

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets		
Cash and cash equivalents	\$ 808,854	\$ 584,150
Accounts receivable	17,455	15,391
Current portion of pledges receivable	1,574,176	1,556,651
Current portion of grants receivable	678,333	687,078
Prepaid expenses	<u>169,624</u>	<u>106,688</u>
Total current assets	3,248,442	2,949,958
Investments	10,551,101	8,049,998
Pledges receivable, net of current portion	5,380,659	6,386,512
Grants receivable, net of current portion	-	140,000
Property and equipment, net	<u>8,113,255</u>	<u>8,575,877</u>
 Total assets	 <u>\$ 27,293,457</u>	 <u>\$ 26,102,345</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities		
Accounts payable	\$ 91,238	\$ 34,787
Accrued expenses	284,558	257,719
Deposits	39,041	13,500
Deferred revenue	<u>448,560</u>	<u>358,331</u>
Total current liabilities	<u>863,397</u>	<u>664,337</u>
Net assets		
Unrestricted net assets		
Montalvo Service Group	204,373	268,547
Unrestricted net assets	<u>8,028,919</u>	<u>8,462,985</u>
Total unrestricted net assets	8,233,292	8,731,532
Temporarily restricted net assets	1,121,391	1,278,945
Permanently restricted net assets	<u>17,075,377</u>	<u>15,427,531</u>
Total net assets	<u>26,430,060</u>	<u>25,438,008</u>
 Total liabilities and net assets	 <u>\$ 27,293,457</u>	 <u>\$ 26,102,345</u>

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION  
Statement of Activities  
For the Year Ended September 30, 2014  
(With Comparative Totals for 2013)

	2014			2013	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Support and revenue					
Support					
Individuals	\$ 851,673	\$ 226,010	1,547,846	\$ 2,625,529	\$ 8,144,336
Grants and contributions	157,864	208,161	100,000	466,025	783,205
Contributions in-kind	651,503	-	-	651,503	568,976
Special events (includes in-kind contributions of \$62,358 and \$33,283)	831,204	-	-	831,204	297,724
Less: direct expenses	(280,851)	-	-	(280,851)	(88,027)
Total support	<u>2,211,393</u>	<u>434,171</u>	<u>1,647,846</u>	<u>4,293,410</u>	<u>9,706,214</u>
Revenue					
Rentals	802,375	-	-	802,375	617,155
Arts programs	790,513	-	-	790,513	769,306
Dividends and interest	40,490	407,342	-	447,832	173,836
Concessions and merchandise	152,656	-	-	152,656	120,688
Net realized and unrealized gain on investments	22,334	153,101	-	175,435	394,417
Other income	-	-	-	-	4,598
Total revenue	<u>1,808,368</u>	<u>560,443</u>	<u>-</u>	<u>2,368,811</u>	<u>2,080,000</u>
Total support and revenue	4,019,761	994,614	1,647,846	6,662,221	11,786,214
Net assets released from restrictions	<u>1,152,168</u>	<u>(1,152,168)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total support, revenue and net assets released from restrictions	<u>5,171,929</u>	<u>(157,554)</u>	<u>1,647,846</u>	<u>6,662,221</u>	<u>11,786,214</u>
Expenses					
Program services	4,386,697	-	-	4,386,697	4,125,127
Supporting services					
Management and general	518,090	-	-	518,090	455,403
Fundraising	765,382	-	-	765,382	739,438
Total supporting services	<u>1,283,472</u>	<u>-</u>	<u>-</u>	<u>1,283,472</u>	<u>1,194,841</u>
Total expenses	<u>5,670,169</u>	<u>-</u>	<u>-</u>	<u>5,670,169</u>	<u>5,319,968</u>
Change in net assets	(498,240)	(157,554)	1,647,846	992,052	6,466,246
Net assets, beginning of year	<u>8,731,532</u>	<u>1,278,945</u>	<u>15,427,531</u>	<u>25,438,008</u>	<u>18,971,762</u>
Net assets, end of year	<u>\$ 8,233,292</u>	<u>\$ 1,121,391</u>	<u>\$ 17,075,377</u>	<u>\$ 26,430,060</u>	<u>\$ 25,438,008</u>

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION  
Statement of Functional Expenses  
For the Year Ended September 30, 2014  
(With Comparative Totals for 2013)

	Program Services	Supporting Services			Total	
		Management and General	Fundraising	Total	2014	2013
Expenses						
Salaries and wages	\$ 1,311,471	\$ 337,852	\$ 507,382	\$ 845,234	\$ 2,156,705	\$ 2,151,309
Payroll taxes and employee benefits	326,925	81,508	84,651	166,159	493,084	459,723
Total salaries and related expenses	1,638,396	419,360	592,033	1,011,393	2,649,789	2,611,032
Donated goods / services	608,795	-	11,316	11,316	620,111	562,610
Artist fees / hospitality	470,063	-	375	375	470,438	456,500
Advertising and publicity	119,013	325	292	617	119,630	124,262
Maintenance	131,422	12,287	4,204	16,491	147,913	144,222
Costs of sales	217,557	3,453	4,822	8,275	225,832	177,839
Production	78,880	3,256	-	3,256	82,136	62,236
Utilities	106,130	5,006	5,004	10,010	116,140	101,995
Printing and publication	40,575	5,997	13,071	19,068	59,643	57,229
Professional fees	107,252	11,278	16,912	28,190	135,442	90,986
Insurance	66,885	3,155	3,153	6,308	73,193	73,590
Supplies	31,619	1,697	223	1,920	33,539	34,574
Cultivation / hospitality	26,834	1,484	18,437	19,921	46,755	31,675
Transportation / vehicles	64,070	-	18	18	64,088	55,241
Consultants	6,900	3,375	9,213	12,588	19,488	8,500
Postage and shipping	11,516	2,403	13,931	16,334	27,850	14,772
Telephone	24,864	3,504	4,753	8,257	33,121	24,948
Conferences, training, dues, subscriptions	11,887	8,920	1,890	10,810	22,697	26,789
Repairs	19,823	935	935	1,870	21,693	3,412
Property tax	6,302	297	297	594	6,896	18,655
Office supplies	4,966	700	949	1,649	6,615	6,642
Travel	11,103	2,623	2,149	4,772	15,875	12,021
Miscellaneous, including bad debt expense	1,167	647	34,017	34,664	35,831	-
Total expenses before depreciation	3,806,019	490,702	737,994	1,228,696	5,034,715	4,699,730
Depreciation	580,678	27,388	27,388	54,776	635,454	620,238
Total functional expenses	\$ 4,386,697	\$ 518,090	\$ 765,382	\$ 1,283,472	\$ 5,670,169	\$ 5,319,968
Percentage of total	77%	9%	14%	23%	100%	

The accompanying notes are an integral part of these financial statements.

MONTALVO ASSOCIATION  
Statement of Cash Flows  
For the Year Ended September 30, 2014  
(With Comparative Totals for 2013)

	2014	2013
Cash flows from operating activities		
Change in net assets	\$ 992,052	\$ 6,466,246
Adjustments to reconcile change in net assets to net cash used in operating activities		
Depreciation	635,454	620,238
Net realized and unrealized gain on investments	(175,435)	(394,417)
Donated property and equipment	(31,392)	(6,366)
Contributions restricted for long-term purposes	(100,000)	(250,000)
Permanently restricted endowment contributions	(2,710,000)	(1,585,000)
Changes in operating assets and liabilities		
Accounts receivable	(2,064)	64,292
Pledges receivable	988,328	(4,697,405)
Grants receivable	148,745	(627,078)
Prepaid expenses	(62,936)	32,532
Accounts payable	56,451	(167,096)
Accrued expenses	26,839	47,620
Deposits	25,541	(10,500)
Deferred revenue	90,229	49,852
Net cash used in operating activities	(118,188)	(457,082)
Cash flows from investing activities		
Purchase of property and equipment	(141,440)	(412,603)
Purchases of investments	(2,854,346)	(2,537,275)
Proceeds from sales of investments	528,678	1,565,981
Net cash used in investing activities	(2,467,108)	(1,383,897)
Cash flows from financing activities		
Cash received restricted for long-term purposes	100,000	250,000
Cash received from permanently restricted endowment contributions	1,520,584	468,995
Cash from sale of donated securities restricted for long term purposes	1,189,416	1,116,005
Net cash provided by financing activities	2,810,000	1,835,000
Net increase (decrease) in and cash equivalents	224,704	(5,979)
Cash and cash equivalents, beginning of year	584,150	590,129
Cash and cash equivalents, end of year	\$ 808,854	\$ 584,150
<u>Supplemental disclosure of non-cash investing activities</u>		
Transfer of construction in progress to property and equipment	\$ 5,691	\$ 484,827
Pledges receivable collected by donated securities	\$ 1,189,416	\$ 1,116,005

The accompanying notes are an integral part of these financial statements.



MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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1. Organization

Montalvo Association, (also known as "Villa Montalvo", "Montalvo Arts Center, or "Montalvo"), is located on a 175-acre estate built in 1912 by James Duval Phelan (1861-1930). A passionate Californian, Phelan was a three-term progressive mayor of San Francisco and California's first popularly-elected U.S. Senator. Montalvo was his favorite home and a center of artistic, political, and social life in Northern California; a cultural haven where he invited leading writers and artists to work on artistic projects in an environment rich in dialogue and fellowship. Upon his death, Senator Phelan bequeathed Montalvo to the people of California as a site for the advancement of art, music, literature, and architecture, a legacy that continues to this day. In 1952 Montalvo was incorporated as a public-benefit nonprofit corporation, with a mission of engaging the community in the creative process.

As a contemporary arts center, Montalvo fosters creativity, nurtures new talent, and inspires active engagement with the arts through commissions of new work, presentation of acclaimed and emerging artists, and the implementation of innovative educational initiatives. Through the distinguished Sally and Don Lucas Artists Residency program; performing arts series; visual arts exhibitions and related public programming; literary arts events; and education and outreach programs, Montalvo successfully connects Silicon Valley with exemplary national and international artistic opportunities. In all its programmatic endeavors, Montalvo is guided by the belief that both relevance and accessibility are of paramount importance.

2. Program Services

Sally and Don Lucas Artists Residency Program

The internationally recognized Sally and Don Lucas Artists Residency Program ("LAP") enhances Montalvo's ability to contribute to the field through the creation of new work by accomplished artists and creative thinkers, serves as the driving force behind its community-based outreach programs, and gives California artists the opportunity to work in close collaboration with peers from around the globe.

Every year, the LAP offers 60+ artists private housing, a professional staff supportive of the creative process, and an environment conducive to individual practice, community engagement, and the energetic exchange of ideas among international and culturally diverse Fellows.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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2. Program Services (continued)

Performing Arts Series

This vibrant interdisciplinary program consists of more than 50 concerts and theatrical performances presented in the 1400-seat Garden Theatre, the intimate 300-seat Carriage House Theatre, and the Grand Hall of the historic Villa. These include shows for adults and children of all ages. As a key part of this series, Montalvo commissions composers and performance artists to create and perform new works.

Exhibitions and Visual Arts Public Programming

Montalvo's visual arts program encompasses a year-round series of exhibitions of various media presented in the Project Space Gallery; arts related classes and workshops; Open Access, a monthly showcase of current work by artists affiliated with the LAP; and Art on the Grounds, which includes both existing and commissioned works of art installed outdoors throughout the property.

Literary Arts Events

Relaunched in 2014, Montalvo's literary series brings authors of various genres (both fiction and non-fiction) to present readings and discuss their creative process with the community.

Education and Outreach

Montalvo's on-site education programs serve 18,000 students annually and consist of a broad range of arts-related programs, classes, and special events. Education programming includes the Family Performing Arts Series ("FPAS") and Performing Arts Series for Students ("PASS"); Master Classes taught by resident artists; professional development for teachers; and visual and performing arts camps. In addition, Montalvo's ground-breaking Teaching Artist Program brings professional teaching artists into Santa Clara County classrooms instructing and inspiring nearly 1,900 additional students each year.

Historic Villa and Extant Buildings

Anchored by the historic Villa Montalvo and the Sally and Don Lucas Artists Residency Program campus, the complex also includes new and historic buildings. Docent-led tours of the Villa and grounds are available to the public monthly.

Gardens and Grounds

The formal Italianate garden, historic Cactus Garden, the Oval Garden, the Love Temple, and several miles of hiking trails comprise the estate's 175-acre grounds. Open for free to the public 363 days a year, they serve nearly a quarter million visitors annually.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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3. Summary of Significant Accounting Policies

Basis of presentation

The financial statements of Montalvo have been prepared on the accrual basis of accounting. Net assets and changes therein are classified as follows:

- Permanently restricted net assets - represent contributions generally to be held in perpetuity as directed by the donors. The income from these contributions is available to support activities of Montalvo as designated by the donors.
- Temporarily restricted net assets - represent contributions whose use by Montalvo is limited in accordance with temporary donor-imposed stipulations. These stipulations may expire with time or may be satisfied by the actions of Montalvo according to the intentions of the donors.
- Unrestricted net assets - represent unrestricted resources available to support Montalvo's operations and temporarily restricted resources that have become available for use by Montalvo in accordance with the intentions of the donors. Under this category, Montalvo maintains an operating fund, property and equipment fund plus any net assets designated by the Board for specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related asset is limited by donor-imposed restrictions. Montalvo recognizes support from temporarily restricted net assets when the restrictions imposed by the donors have been satisfied or expired. Expenses are reported as decreases in unrestricted net assets. Gains and losses on assets and liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor restriction or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Revenue from grants which have been classified as "exchange transactions" and program fees are recognized as revenue in the period in which the service is provided.

Comparative financial information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class or functional expense categories. 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 Montalvo's financial statements for the year ended September 30, 2013, from which the summarized information was derived.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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3. Summary of Significant Accounting Policies (continued)

Use of 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 support, revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. Montalvo maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. Montalvo has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Pledges and grants receivables

Unconditional promises to give are recorded at their net realizable value. If such promises to give are due in more than one year, they are discounted to the present value of their estimated future cash flows using a market rate. Reserves for potential uncollectable contributions receivable are maintained based on historical credit losses and management's expectations. Montalvo 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, 2014, Montalvo considers all pledges and grants receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary.

Conditional promises to give, if any, are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Investments

Investments consist of money market funds, domestic and international marketable equity securities, debt securities, and certificates of deposit with original maturity dates greater than three months. All investments are stated at fair values using quoted market prices. Realized and unrealized gains and losses are included in the accompanying statement of activities. Investment income and gains restricted by a donor are reported as increases in restricted net assets.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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3. Summary of Significant Accounting Policies (continued)

Fair value measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. In determining fair value, Montalvo uses various valuation approaches. A hierarchy has been established for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of Montalvo. Unobservable inputs are inputs that reflect Montalvo's assumptions about what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of financial instruments:

Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect Montalvo's estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Property and equipment

Property and equipment are recorded at cost or estimated fair value for donated items. Equipment purchases over \$5,000 are capitalized. The cost of repairs and maintenance which do not improve or extend the lives of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 30 years. Depreciation is charged to the activity benefiting from the use of the property or equipment.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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3. Summary of Significant Accounting Policies (continued)

Long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Recoverability of assets is measured by comparison of the carrying amount of the asset to the net undiscounted future cash flows expected to be generated from the asset. If the future undiscounted cash flows are not sufficient to recover the carrying value of the assets, the assets' carrying value is adjusted to fair value. Donated equipment is recorded as a contribution at its estimated fair value on the date of receipt. Such donations are reported as unrestricted support unless the donor has restricted the donated asset for a specific purpose. Absent explicit donor stipulations about how long those long-lived assets must be maintained, Montalvo reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Collections

Collection items acquired either through purchase or donation are not capitalized. Purchases of collection items are recorded as decreases in unrestricted net assets if purchased with unrestricted assets and as decreases in temporarily restricted or permanently restricted net assets if purchased with donor-restricted assets. Contributions of collection items are not recognized in the statement of activities. Proceeds from deaccessions or insurance recoveries are reflected in the statement of activities based on the absence or existence and nature of donor-imposed restrictions.

Deferred revenue

Montalvo receives payments during the year in advance for various performances and for park rental. As of September 30, 2014, \$448,560 had not been earned and has been recorded as deferred revenue.

Contributions in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. The contributions of goods and services are recognized if they (a) create or enhance nonfinancial assets or (b) require specialized skills that are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. Montalvo also receives donated services that do not require specific expertise but which are nonetheless central to Montalvo's operations. While these contributed services are not reflected in the financial statements the estimated value of these services is disclosed in Note 10.

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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3. Summary of Significant Accounting Policies (continued)

Functional expense allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Indirect expenses are allocated based upon estimated functional usage by time, square footage or other appropriate means.

Income taxes

Montalvo is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements. In addition, Montalvo qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Montalvo evaluated its current tax positions and has concluded that as of September 30, 2014, Montalvo does not have any significant uncertain tax positions for which a reserve or disclosure would be necessary.

Advertising

Montalvo's policy is to expense advertising costs as the costs are incurred. Advertising expense for the year ended September 30, 2014 was \$119,630.

4. Pledges and Grants Receivable

Pledges and grants receivable consisted of the following at September 30, 2014:

Due in less than one year	\$2,252,509
Due in one to five years	5,088,333
Due in more than five years	<u>530,000</u>
Total	7,870,842
Less: discount on multi-year contributions and grants receivable	<u>(237,674)</u>
Contributions and grants receivable, net	7,633,168
Less: current portion	<u>(2,252,509)</u>
Contributions and grants receivable, noncurrent, net of discount	<u>\$5,380,659</u>

MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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4. Pledges and Grants Receivable (continued)

For pledges and grants expected to be collected in more than one year a present value discount is estimated based on an applicable market rate at the time of the promise as adjusted for credit and other donor specific risks. The risk-adjusted discount rates on pledges and grants receivable received during the year ended September 30, 2014 ranged from 0.33% to 2.64%.

During the year ended September 30, 2014, Montalvo received a conditional pledge of \$500,000. The pledge will be recognized upon Montalvo receiving matching funds from additional donors totaling \$500,000 (see Note 14).

5. Investments

Montalvo's investments are recorded at fair value and have been categorized based upon a fair value hierarchy. Investments held at September 30, 2014 are valued using Level 1 inputs (see Note 3), and were as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$ 2,297,002	\$ -	\$ -	\$ 2,297,002
Domestic equity funds	6,684,662	-	-	6,684,662
Domestic bond funds	<u>1,569,437</u>	<u>-</u>	<u>-</u>	<u>1,569,437</u>
Total	<u>\$10,551,101</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$10,551,101</u>

6. Property and Equipment

The cost and related accumulated depreciation of property and equipment at September 30, 2014 consisted of the following:

Artists residency	\$ 8,633,511
Building improvements	4,757,228
Carriage house	1,263,208
Office equipment	748,462
Building improvements - East Wing	534,755
Gallery	472,172
Furniture and fixtures	403,746
Land improvements	625,864
Construction in progress	37,121
Vehicles	92,506
Land	<u>53,000</u>
	17,621,573
Less: accumulated depreciation and amortization	<u>(9,508,318)</u>
Property and equipment, net	<u>\$ 8,113,255</u>



MONTALVO ASSOCIATION  
Notes to Financial Statements  
September 30, 2014

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6. Property and Equipment (continued)

Property and equipment have been recorded at cost, or fair value if donated, together with related depreciation expense. Montalvo's policy is to remove property and equipment from the accounts once they have been fully depreciated. Depreciation and amortization expense for the year ended September 30, 2014 was \$635,454.

7. Credit Facility

At September 30, 2014, Montalvo had an available line of credit to finance cash flow in the amount of \$250,000. The line of credit bears interest at the U.S. prime rate plus 1%. As of September 30, 2014, the interest rate was 4.25%. The line of credit was renewed on April 10, 2014 for an additional twelve month period and is secured by certain Montalvo assets. At September 30, 2014, there was no outstanding balance on the line of credit.

8. Temporarily Restricted Net Assets

Montalvo's temporarily restricted net assets consistent of the following as of September 30, 2014:

Purpose restrictions	
Capital projects	\$ 271,065
Other	58,100
Time restrictions	456,644
Endowment earnings	<u>335,582</u>
Total temporarily restricted net assets	<u>\$1,121,391</u>

Net assets were released from restrictions during the year by incurring expenses satisfying the restricted purpose or the occurrence of other events specified by donors during the year ended September 30, 2014 as follows:

Purpose restriction	\$ 464,098
Time restriction	254,000
Appropriated endowment earnings	<u>434,070</u>
Total net assets released from restrictions	<u>\$1,152,168</u>

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9. Endowment

The Montalvo Endowment Fund consists of its donor-restricted endowment fund. Net assets associated with these endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The permanently restricted net assets of these funds consist of the following on September 30, 2014:

Lucas Artists Program	\$ 8,333,792
General operations	6,984,933
Capital improvements	1,407,844
Education	<u>348,808</u>
Total	<u>\$17,075,377</u>

As of September 30, 2014, \$7,368,192 of permanently restricted net assets are included as pledges and grants receivable in the accompanying statement of financial position.

Interpretation of relevant law

The Board of Trustees of Montalvo has interpreted the California version of the Uniform Prudent Management of Institutional Funds Act ("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, Montalvo 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 Montalvo in a manner consistent with the standard of prudence prescribed by the California version of UPMIFA.

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9. Endowment (continued)

Interpretation of relevant law (continued)

In accordance with the California version of UPMIFA, Montalvo 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 Montalvo 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 Montalvo
7. The investment policies of Montalvo

Investment return objectives, risk parameters and strategies

The primary objective for Montalvo's investment policy has been to employ a total return approach to achieve long-term growth with meaningful exposure to equities, placing current income as a secondary consideration. This is consistent with the original investment goals of preservation of the purchasing power of capital and the construction of a well-diversified, high-quality investment portfolio. Currently, the target asset allocation is approximately 50% equities. The minimum total return objective over a market cycle (3-5 years) has been to exceed the inflation rate by 3% net of fees. The investment time horizon for the fund is long. Historically, the fund has possessed an above average tolerance for risk as defined by the ability to withstand moderate fluctuations in account value over a market cycle. This is in keeping with the objective of growth within long term horizons.

Spending policy and how the investment objectives relate to spending policy

In accordance with, and subject to, the principal requisite UPMIFA factors set forth above, Montalvo's distribution guidelines shall be as follows:

Montalvo's Finance Committee may authorize disbursement each year, for the general budgetary purposes of Montalvo, 4 - 6% of the fair market value of donor restricted endowment funds based on the Finance Committee's annual determination.

In addition, no borrowing from the donor-restricted endowment fund may be allowed at any time. Except for the UPMIFA requirements and the guidelines regarding distribution of principal or borrowing from the donor-restricted endowment fund as set forth in detail above, Montalvo's distribution guidelines may be modified at the sole discretion of the Board of Trustees as may be necessary to meet the needs of Montalvo.

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9. Endowment (continued)

Spending policy and how the investment objectives relate to spending policy (continued)

Endowment net asset composition by type of fund as of September 30, 2014 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$335,582	\$17,075,377	\$17,410,959

Changes in endowment net assets for the year ended September 30, 2014:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -	\$209,209	\$15,427,531	\$15,636,740
Contributions	-	-	1,647,846	1,647,846
Dividends and interest	-	407,342	-	407,342
Net realized and unrealized gain	-	153,101	-	153,101
Appropriated investment earnings	-	(434,070)	-	(434,070)
Endowment net assets, end of year	<u>\$ -</u>	<u>\$335,582</u>	<u>\$17,075,377</u>	<u>\$17,410,959</u>

10. Contributions In-Kind

The estimated fair value of donated supplies, furniture, equipment, expert services and facilities are recorded as contributions. During the year ended September 30, 2014, the following in-kind contributions were received by Montalvo:

Media sponsorship	\$516,156
Donated property and equipment	31,392
Special events	62,358
Other	<u>103,955</u>
Total contributions in-kind	<u>\$713,861</u>

Montalvo recorded expenses totaling \$682,469, including \$62,358 related to special event direct expenses reported as a reduction to revenue, and capitalized property and equipment totaling \$31,392 related to in-kind contributions during the year ended September 30, 2014 as reflected in the accompanying statement of functional expenses and statement of cash flows, respectively.

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10. Contributions In-Kind (continued)

During the year ended September 30, 2014, Montalvo also received donated services from volunteers that do not require specific expertise but which are nonetheless central to Montalvo's operations. During the year ended September 30, 2014, volunteers and the Montalvo Service Group contributed 16,975 hours of services in support of cultural arts activities. The estimated value of volunteer hours based on the nature of the service and the amount of time donated is estimated to be \$382,786. In accordance with generally accepted accounting principles the value of these services is not reflected in the financial statements.

11. Related Party Transactions

Montalvo's volunteer executive board members are active in both the oversight of the fundraising events, activities and making private contributions. Contributions received from the board of trustee members were approximately \$2,152,234 for the year ended September 30, 2014.

12. Employee Benefit Plan

During 2000, Montalvo established a defined contribution plan for all eligible employees who are 18 years or above and has completed three months of service. Montalvo is allowed to make a discretionary contribution equal to 3% of all eligible employees' compensation. No contribution was made to this plan for the year ended September 30, 2014.

13. Montalvo Service Group

The Montalvo Service Group (the "MSG") was established in 1954. Its primary purpose is to provide financial assistance to Montalvo. The MSG is an internal part of Montalvo, but operates under separate bylaws as a committee of Montalvo. During the year ended September 30, 2014, cash of approximately \$72,000 was transferred by the MSG to Montalvo primarily for various facility repairs.

14. Subsequent Events

Montalvo has evaluated subsequent events through January 26, 2015, the date the financial statements were available to be issued.

During December 2014, Montalvo collected \$3,000,000 of outstanding pledges receivable.

During December 2014, Montalvo recognized its \$500,000 conditional pledge (see Note 4) as the required matching funds from additional donors totaling \$500,000 were committed and the condition was substantially met.