

Montalvo Association

Financial Statements

September 30, 2016
(With Comparative Totals for 2015)



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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Montalvo Association
Saratoga, California

We have audited the accompanying financial statements of Montalvo Association (a California nonprofit corporation) (the "Organization"), which comprise the statement of financial position as of September 30, 2016, 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 (the "U.S."); 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 U.S. 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, 2016, 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 U.S.

Report on Summarized Comparative Information

We have previously audited Montalvo Association's 2015 financial statements, and our report dated January 26, 2016 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, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

A handwritten signature in black ink that reads "Armanino LLP". The signature is written in a cursive, flowing style.

Armanino^{LLP}
San Ramon, California

February 3, 2017

Montalvo Association
Statement of Financial Position
September 30, 2016
(With Comparative Totals for 2015)

	2016	2015
ASSETS		
Current assets		
Cash and cash equivalents	\$ 815,801	\$ 678,320
Accounts receivable	18,465	31,066
Current portion of contributions receivable	524,661	515,634
Current portion of grants receivable	680,000	531,975
Prepaid expenses	<u>187,273</u>	<u>134,282</u>
Total current assets	<u>2,226,200</u>	<u>1,891,277</u>
Property and equipment, net	<u>9,258,479</u>	<u>7,864,899</u>
Other assets		
Investments	15,041,301	14,018,717
Contributions receivable, net of current portion	1,554,215	2,381,913
Grants receivable, net of current portion	150,000	10,000
Collections (Note 14)	<u>-</u>	<u>-</u>
Total other assets	<u>16,745,516</u>	<u>16,410,630</u>
Total assets	<u>\$ 28,230,195</u>	<u>\$ 26,166,806</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable	\$ 130,887	\$ 63,029
Accrued expenses	512,039	290,310
Deposits	53,000	42,000
Deferred revenue	<u>479,856</u>	<u>373,864</u>
Total current liabilities	<u>1,175,782</u>	<u>769,203</u>
Net assets		
Unrestricted		
Montalvo Service Group	211,066	165,507
Unrestricted	<u>8,303,847</u>	<u>6,894,464</u>
Total unrestricted	8,514,913	7,059,971
Temporarily restricted	1,250,967	1,061,391
Permanently restricted	<u>17,288,533</u>	<u>17,276,241</u>
Total net assets	<u>27,054,413</u>	<u>25,397,603</u>
Total liabilities and net assets	<u>\$ 28,230,195</u>	<u>\$ 26,166,806</u>

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

Montalvo Association
Statement of Activities
For the Year Ended September 30, 2016
(With Comparative Totals for 2015)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2016 Total</u>	<u>2015 Total</u>
Support and revenue					
Support					
Individuals	\$ 1,018,327	\$ 1,861,560	\$ 62,292	\$ 2,942,179	\$ 1,838,303
Grants and contributions	137,242	982,022	-	1,119,264	706,361
Contributions in-kind	184,283	-	-	184,283	174,008
Proceeds from special events	889,919	-	-	889,919	527,498
Special event direct expenses	<u>(245,663)</u>	<u>-</u>	<u>-</u>	<u>(245,663)</u>	<u>(129,742)</u>
Total support	<u>1,984,108</u>	<u>2,843,582</u>	<u>62,292</u>	<u>4,889,982</u>	<u>3,116,428</u>
Revenue and gains (losses)					
Rentals	1,005,910	-	-	1,005,910	1,034,140
Art programs	901,908	-	-	901,908	843,615
Interest and dividend income	358,907	274,312	-	633,219	617,392
Concessions and merchandise	240,056	-	-	240,056	209,651
Loss on disposal of assets	(23,630)	-	-	(23,630)	-
Net assets released from restriction	<u>2,828,318</u>	<u>(2,828,318)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total revenue and gains (losses)	<u>5,311,469</u>	<u>(2,554,006)</u>	<u>-</u>	<u>2,757,463</u>	<u>2,704,798</u>
Total support, revenue, and gains (losses)	<u>7,295,577</u>	<u>289,576</u>	<u>62,292</u>	<u>7,647,445</u>	<u>5,821,226</u>
Functional expenses					
Programs	<u>4,564,638</u>	<u>-</u>	<u>-</u>	<u>4,564,638</u>	<u>4,176,824</u>
Support services					
Management and general	780,014	-	-	780,014	619,895
Fundraising	<u>769,734</u>	<u>-</u>	<u>-</u>	<u>769,734</u>	<u>786,133</u>
Total support services	<u>1,549,748</u>	<u>-</u>	<u>-</u>	<u>1,549,748</u>	<u>1,406,028</u>
Total functional expenses	<u>6,114,386</u>	<u>-</u>	<u>-</u>	<u>6,114,386</u>	<u>5,582,852</u>
Change in net assets from operations	<u>1,181,191</u>	<u>289,576</u>	<u>62,292</u>	<u>1,533,059</u>	<u>238,374</u>
Non-operating activity					
Net realized and unrealized gains (losses) on investments	373,751	-	-	373,751	(1,270,831)
Collection item purchased but not capitalized (Note 14)	<u>(100,000)</u>	<u>(150,000)</u>	<u>-</u>	<u>(250,000)</u>	<u>-</u>
Total non-operating activity	<u>273,751</u>	<u>(150,000)</u>	<u>-</u>	<u>123,751</u>	<u>(1,270,831)</u>
Change in net assets	1,454,942	139,576	62,292	1,656,810	(1,032,457)
Net assets, beginning of year	7,059,971	1,061,391	17,276,241	25,397,603	26,430,060
Change in donor-imposed restriction	<u>-</u>	<u>50,000</u>	<u>(50,000)</u>	<u>-</u>	<u>-</u>
Net assets, end of year	<u>\$ 8,514,913</u>	<u>\$ 1,250,967</u>	<u>\$ 17,288,533</u>	<u>\$ 27,054,413</u>	<u>\$ 25,397,603</u>

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

Montalvo Association
Statement of Functional Expenses
For the Year Ended September 30, 2016
(With Comparative Totals for 2015)

	<u>Support services</u>			2016 Total	2015 Total
	<u>Programs</u>	<u>Management and general</u>	<u>Fundraising</u>		
Salaries and related expenses					
Salaries and wages	\$ 1,634,012	\$ 453,388	\$ 513,623	\$ 967,011	\$ 2,601,023
Payroll taxes and benefits	398,616	79,153	97,099	176,252	574,868
Total salaries and related expenses	2,032,628	532,541	610,722	1,143,263	3,175,891
Donated goods / services	153,652	-	25,490	25,490	179,142
Artist fees / hospitality	567,051	-	400	400	567,451
Advertising and publicity	153,789	5,758	2,891	8,649	162,438
Maintenance	207,329	9,775	9,684	19,459	226,788
Costs of sales	252,708	3,166	17,957	21,123	273,831
Production	75,303	15,139	-	15,139	90,442
Utilities	100,937	4,761	4,761	9,522	110,459
Printing and publication	49,997	4,246	3,428	7,674	57,671
Professional fees	2,122	120,993	-	120,993	123,115
Insurance	75,054	3,540	3,540	7,080	82,134
Supplies	55,258	2,606	2,606	5,212	60,470
Cultivation / hospitality	19,415	10,500	27,365	37,865	57,280
Transportation / vehicles	59,450	6,372	-	6,372	65,822
Consulting fees	26,654	13,369	4,550	17,919	44,573
Postage and shipping	12,290	1,834	15,774	17,608	29,898
Telephone	35,933	4,989	5,367	10,356	46,289
Conferences, trainings, dues and subscriptions	18,533	8,108	1,203	9,311	27,844
Repairs	32,050	1,512	1,511	3,023	35,073
Property taxes	9,719	459	458	917	10,636
Office supplies	5,951	825	887	1,712	7,663
Travel	13,309	2,249	1,462	3,711	17,020
Miscellaneous, including bad debt expense	29,677	112	2,519	2,631	32,308
Depreciation	575,829	27,160	27,159	54,319	630,148
	<u>\$ 4,564,638</u>	<u>\$ 780,014</u>	<u>\$ 769,734</u>	<u>\$ 1,549,748</u>	<u>\$ 6,114,386</u>
Percentage of total	<u>74.7 %</u>	<u>12.8 %</u>	<u>12.5 %</u>	<u>25.3 %</u>	<u>100.0 %</u>

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

Montalvo Association
Statement of Cash Flows
For the Year Ended September 30, 2016
(With Comparative Totals for 2015)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Change in net assets	\$ 1,656,810	\$ (1,032,457)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	630,148	590,181
Net realized and unrealized (gain) loss on investments	(373,751)	1,270,831
Loss on disposal of property and equipment	23,630	-
Purchase of art collection	150,000	-
Contributions restricted for long-term purposes	(1,974,868)	(200,000)
Permanently restricted endowment contributions	(670,000)	(4,647,333)
Changes in operating assets and liabilities		
Accounts receivable	12,601	(13,611)
Contributions receivable	930,917	4,057,288
Grants receivable	(350,317)	136,358
Prepaid expenses	(52,991)	35,342
Accounts payable	67,858	(28,209)
Accrued expenses	221,729	5,752
Deposits	11,000	2,959
Deferred revenue	<u>105,992</u>	<u>(74,696)</u>
Net cash provided by operating activities	<u>388,758</u>	<u>102,405</u>
Cash flows from investing activities		
Purchases of property and equipment	(2,047,357)	(341,825)
Purchases of investments	(2,497,271)	(7,142,872)
Proceeds from sales of investments	1,402,309	2,404,425
Purchase of art collection	<u>(150,000)</u>	<u>-</u>
Net cash used in investing activities	<u>(3,292,319)</u>	<u>(5,080,272)</u>
Cash flows from financing activities		
Cash received restricted for long-term purposes	1,974,868	200,000
Cash received from permanently restricted endowment contributions	620,000	745,052
Cash from sale of donated securities restricted for long-term purposes	<u>446,174</u>	<u>3,902,281</u>
Net cash provided by financing activities	<u>3,041,042</u>	<u>4,847,333</u>
Net increase (decrease) in cash and cash equivalents	137,481	(130,534)
Cash and cash equivalents, beginning of year	<u>678,320</u>	<u>808,854</u>
Cash and cash equivalents, end of year	<u>\$ 815,801</u>	<u>\$ 678,320</u>
Supplemental schedule of noncash investing and financing activities		
Contributions receivable collected by donated securities	\$ 446,174	\$ 3,902,281
Purchase of art collection included in accrued expenses	\$ 100,000	\$ -

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

Montalvo Association
Notes to Financial Statements
September 30, 2016

1. NATURE OF OPERATIONS

Montalvo Association, (also known as "Villa Montalvo", "Montalvo Arts Center", "Montalvo", or the "Organization"), 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. PROGRAMS

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, 2016

2. PROGRAMS (continued)

OneBeat

In October 2015, Montalvo's LAP hosted OneBeat, an initiative of the US Department of State's Bureau of Educational and Cultural Affairs, and produced by Found Sound Nation, the social engagement wing of Bang on a Can. Bringing together 25 young musicians from 17 different countries and territories to the U.S. for one month, OneBeat participants collaboratively write and perform original music, and develop strategies for arts-based social engagement. OneBeat musicians began their term with a two-week residency at Montalvo, during which they created new original material, and engaged with the community, conducting workshops for local school children and performing a large-scale musical festival. OneBeat then departed Montalvo for a tour through the Pacific Northwest, performing for a wide array of American audiences, collaborating with local musicians, and leading additional workshops for youth.

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.

Montalvo Association
Notes to Financial Statements
September 30, 2016

2. PROGRAMS (continued)

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting and financial statement presentation

The financial statements of Montalvo have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Net assets and changes therein are classified as follows:

- *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.
- *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. Temporarily restricted net assets also include the portion of donor-restricted endowment funds that are not classified as permanently restricted, until such funds are appropriated for expenditure by Montalvo.
- *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.

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.

Montalvo Association
Notes to Financial Statements
September 30, 2016

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of accounting and financial statement presentation (continued)

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

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.

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 value 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.

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.

Montalvo Association
Notes to Financial Statements
September 30, 2016

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurements (continued)

- *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 as incurred. 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.

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.

Contributions and promises to give

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 uncollectable receivables. The allowance, if any, is based on prior years' experience and management's analysis of specific promises made by the donors.

As of September 30, 2016, Montalvo considers all contributions 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.

Montalvo Association
Notes to Financial Statements
September 30, 2016

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred revenue

Montalvo receives payments during the year in advance for various performances and for park rental. As of September 30, 2016, \$479,856 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 11.

Functional expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the accompanying statement of activities and 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.

Advertising costs

Montalvo's policy is to expense advertising costs as the costs are incurred. Advertising expense for the year ended September 30, 2016 totaled \$162,438.

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.

Montalvo Association
Notes to Financial Statements
September 30, 2016

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax status

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, 2016, Montalvo does not have any significant uncertain tax positions for which a reserve or disclosure would be necessary.

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.

Summarized 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, 2015, from which the summarized information was derived.

Subsequent events

Montalvo has evaluated subsequent events through February 3, 2017, the date the financial statements were available to be issued. No subsequent events occurred that would have a material effect on the presentation of the financial statements.

Montalvo Association
Notes to Financial Statements
September 30, 2016

4. CONTRIBUTIONS AND GRANTS RECEIVABLE

Contributions and grants receivable consist of the following:

Due in less than one year	\$ 1,204,661
Due in one to five years	1,520,000
Due in more than five years	<u>270,000</u>
	2,994,661
Less: discount on multi-year contributions and grants receivable	<u>(85,785)</u>
	<u><u>\$ 2,908,876</u></u>

For contributions 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 contributions and grants receivable received during the year ended September 30, 2016 ranged from 0.59% to 1.60%.

5. INVESTMENTS

The following table sets forth by level, within the fair value hierarchy, the Organization's assets and liabilities at fair value as of September 30, 2016:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 776,337	\$ -	\$ -	\$ 776,337
Domestic equity funds	3,839,364	-	-	3,839,364
Domestic bond funds	<u>10,425,600</u>	<u>-</u>	<u>-</u>	<u>10,425,600</u>
	<u><u>\$15,041,301</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$15,041,301</u></u>

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6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Artist residency	\$ 8,642,846
Building improvements	5,472,141
Land improvements	2,745,691
Carriage house	1,356,452
Office equipment	710,910
Gallery	472,172
Furniture and fixtures	408,693
Vehicles	92,506
Land	53,000
Construction in progress	<u>10,183</u>
	19,964,594
Accumulated depreciation	<u>(10,706,115)</u>
	<u><u>\$ 9,258,479</u></u>

Depreciation and amortization expense for the year ended September 30, 2016 totaled \$630,148.

7. LINE OF CREDIT

At September 30, 2016, Montalvo had an available line of credit to finance cash flow in the amount of \$250,000. The line of credit matures in March 2018. At September 30, 2016, there was no outstanding balance on the line of credit. The line of credit bears interest at the U.S. prime rate plus 1%. As of September 30, 2016, the interest rate was 4.25%.

8. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following:

Purpose restricted - capital projects	\$ 301,910
Purpose restricted - other	90,742
Time restricted	<u>858,315</u>
	<u><u>\$ 1,250,967</u></u>

Temporarily restricted net assets released from restriction during the year were as follows:

Purpose restricted	\$ 2,216,389
Time restricted	337,617
Appropriated endowment earnings	<u>274,312</u>
	<u><u>\$ 2,828,318</u></u>

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9. PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of the following:

Lucas Artists Program	\$ 8,333,792
Villa and grounds	6,554,676
General operations	2,051,257
Education	<u>348,808</u>
	<u>\$ 17,288,533</u>

As of September 30, 2016, approximately \$2,300,000 of permanently restricted net assets are included as contributions and grants receivable in the accompanying statement of financial position.

10. ENDOWMENT

Montalvo's endowment consists of several individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds. As required by U.S. GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law

The Board of Trustees of Montalvo has interpreted 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 UPMIFA.

In accordance with the California version UPMIFA, Montalvo considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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10. ENDOWMENT (continued)

Interpretation of relevant law (continued)

- (1) The duration and preservation of the fund
- (2) The purposes of the organization 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

Return objectives and risk parameters

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. 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.

Funds with deficiencies

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the permanently restricted net assets balance. Due to unrealized losses on equity securities within endowment funds during the year ended September 30, 2016, the fair value of donor restricted endowment assets was approximately \$318,000 less than the permanently restricted net asset balance as of September 30, 2016.

Spending policy

In accordance with, and subject to, the principal requisite UPMIFA factors set forth above, Montalvo's distribution guidelines are 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.

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10. ENDOWMENT (continued)

Spending policy (continued)

In addition, no borrowing from the donor-restricted endowment fund may be allowed at any time except in accordance with specific donor intentions. 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.

Endowment composition

Endowment net asset composition by type of fund as of September 30, 2016 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (317,688)	\$ -	\$17,288,533	\$16,970,845

Changes in endowment net assets for the fiscal year ended September 30, 2016 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance, September 30, 2015	\$ (732,815)	\$ -	\$17,276,241	\$16,543,426
Investment return				
Interest and dividend income	358,485	274,312	-	632,797
Net realized and unrealized gains	<u>374,330</u>	<u>-</u>	<u>-</u>	<u>374,330</u>
Total investment return	732,815	274,312	-	1,007,127
Contributions	-	-	62,292	62,292
Appropriated investment earnings	(317,688)	(274,312)	-	(592,000)
Change in donor-imposed restriction	<u>-</u>	<u>-</u>	<u>(50,000)</u>	<u>(50,000)</u>
	<u>415,127</u>	<u>-</u>	<u>12,292</u>	<u>427,419</u>
Balance, September 30, 2016	<u>\$ (317,688)</u>	<u>\$ -</u>	<u>\$17,288,533</u>	<u>\$16,970,845</u>

11. CONTRIBUTIONS IN-KIND

The estimated fair value of donated supplies, furniture, equipment, expert services and facilities are recorded as contributions.

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11. CONTRIBUTIONS IN-KIND (continued)

Contributions in-kind are as follows:

Special events	\$ 99,453
Other	<u>184,283</u>
	<u>\$ 283,736</u>

During the year ended September 30, 2016, 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, 2016, volunteers and the Montalvo Service Group contributed 20,195 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 \$509,116. In accordance with generally accepted accounting principles the value of these services is not reflected in the financial statements.

12. 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 Board of Trustee members totaled approximately \$80,000 for the year ended September 30, 2016.

13. 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. During 2016, the plan was amended to provide for an employer matching contribution. Employer matching contributions made to the plan by Montalvo totaled \$39,686 during the year ended September 30, 2016.

14. COLLECTIONS

Montalvo's collections are comprised of art objects held for educational and artistic purposes. Each item is cataloged, preserved, and cared for, and activities assessing their condition are performed periodically. Proceeds from sales of collection items are used solely to acquire other items for collections.

During the year ended September 30, 2016, Montalvo received contributions totaling \$178,200, included as temporarily restricted contributions in the accompanying statement of activities, for the purpose of acquiring a collection item. Contributions received for the purpose of acquiring the collection item include \$25,000 of outstanding contributions receivable as of September 30, 2016. As of September 30, 2016, Montalvo acquired the collection item for \$150,000 and is required to pay an additional \$100,000, included in accrued expenses in the accompanying statement of financial position, towards the purchase price of the item by April 15, 2018.

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15. 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, 2016, cash of approximately \$98,850 was transferred by the MSG to Montalvo primarily for various facility repairs.