

**Montalvo Association**

Financial Statements

September 30, 2017  
(With Comparative Totals for 2016)



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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, 2017, 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, 2017, 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 2016 financial statements, and our report dated February 3, 2017 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, 2016, 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<sup>LLP</sup>  
San Jose, California

January 25, 2018

Montalvo Association  
Statement of Financial Position  
September 30, 2017  
(With Comparative Totals for 2016)

	2017	2016
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 657,808	\$ 815,801
Accounts receivable	32,869	18,465
Current portion of contributions receivable	261,084	524,661
Current portion of grants receivable	155,000	680,000
Prepaid expenses	<u>176,133</u>	<u>187,273</u>
Total current assets	<u>1,282,894</u>	<u>2,226,200</u>
Property and equipment, net	<u>8,919,674</u>	<u>9,258,479</u>
Other assets		
Investments	17,224,075	15,041,301
Contributions receivable, net of current portion	857,409	1,554,215
Grants receivable, net of current portion	-	150,000
Collections (Note 14)	-	-
Total other assets	<u>18,081,484</u>	<u>16,745,516</u>
Total assets	<u>\$ 28,284,052</u>	<u>\$ 28,230,195</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities		
Accounts payable	\$ 176,015	\$ 130,887
Accrued expenses	488,117	512,039
Deposits	40,500	53,000
Deferred revenue	<u>427,985</u>	<u>479,856</u>
Total current liabilities	<u>1,132,617</u>	<u>1,175,782</u>
Net assets		
Unrestricted		
Montalvo Service Group	266,854	211,066
Unrestricted	<u>8,186,562</u>	<u>8,303,847</u>
Total unrestricted	8,453,416	8,514,913
Temporarily restricted	1,468,321	1,250,967
Permanently restricted	<u>17,229,698</u>	<u>17,288,533</u>
Total net assets	<u>27,151,435</u>	<u>27,054,413</u>
Total liabilities and net assets	<u>\$ 28,284,052</u>	<u>\$ 28,230,195</u>

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

Montalvo Association  
Statement of Activities  
For the Year Ended September 30, 2017  
(With Comparative Totals for 2016)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2017 Total</u>	<u>2016 Total</u>
Support and revenue					
Support					
Individuals	\$ 1,197,904	\$ 260,118	\$ 56,165	\$ 1,514,187	\$ 2,942,179
Grants and contributions	96,296	155,348	-	251,644	1,119,264
Contributions in-kind	205,718	-	-	205,718	184,283
Proceeds from special events	740,174	5,000	-	745,174	889,919
Special event direct expenses	<u>(294,400)</u>	<u>-</u>	<u>-</u>	<u>(294,400)</u>	<u>(245,663)</u>
Total support	<u>1,945,692</u>	<u>420,466</u>	<u>56,165</u>	<u>2,422,323</u>	<u>4,889,982</u>
Revenue and gains (losses)					
Rentals	1,016,389	-	-	1,016,389	1,005,910
Art programs	894,334	-	-	894,334	901,908
Interest and dividend income	526	468,111	-	468,637	633,219
Concessions and merchandise	154,958	-	-	154,958	240,056
Loss on disposal of assets	-	-	-	-	(23,630)
Net assets released from restriction	<u>1,802,113</u>	<u>(1,802,113)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total revenue and gains (losses)	<u>3,868,320</u>	<u>(1,334,002)</u>	<u>-</u>	<u>2,534,318</u>	<u>2,757,463</u>
Total support, revenue and gains (losses)	<u>5,814,012</u>	<u>(913,536)</u>	<u>56,165</u>	<u>4,956,641</u>	<u>7,647,445</u>
Functional expenses					
Programs	<u>4,796,692</u>	<u>-</u>	<u>-</u>	<u>4,796,692</u>	<u>4,564,638</u>
Support services					
Management and general	687,262	-	-	687,262	780,014
Fundraising	<u>712,204</u>	<u>-</u>	<u>-</u>	<u>712,204</u>	<u>769,734</u>
Total support services	<u>1,399,466</u>	<u>-</u>	<u>-</u>	<u>1,399,466</u>	<u>1,549,748</u>
Total functional expenses	<u>6,196,158</u>	<u>-</u>	<u>-</u>	<u>6,196,158</u>	<u>6,114,386</u>
Change in net assets from operations	<u>(382,146)</u>	<u>(913,536)</u>	<u>56,165</u>	<u>(1,239,517)</u>	<u>1,533,059</u>
Non-operating activity					
Net realized and unrealized gains on investments	320,649	1,015,890	-	1,336,539	373,751
Change in donor imposed restrictions	-	115,000	(115,000)	-	-
Collection item purchased but not capitalized	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(250,000)</u>
Total non-operating activity	<u>320,649</u>	<u>1,130,890</u>	<u>(115,000)</u>	<u>1,336,539</u>	<u>123,751</u>
Change in net assets	(61,497)	217,354	(58,835)	97,022	1,656,810
Net assets, beginning 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>
Net assets, end of year	<u>\$ 8,453,416</u>	<u>\$ 1,468,321</u>	<u>\$ 17,229,698</u>	<u>\$ 27,151,435</u>	<u>\$ 27,054,413</u>

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

Montalvo Association  
Statement of Functional Expenses  
For the Year Ended September 30, 2017  
(With Comparative Totals for 2016)

	<u>Support Services</u>			2017 Total	2016 Total
	<u>Programs</u>	<u>Management and General</u>	<u>Fundraising</u>		
Salaries and related expenses					
Salaries and wages	\$ 1,748,178	\$ 477,317	\$ 457,740	\$ 935,057	\$ 2,683,235
Payroll taxes and benefits	413,032	72,302	97,792	170,094	583,126
Total salaries and related expenses	2,161,210	549,619	555,532	1,105,151	3,266,361
Artist fees / hospitality	542,283	400	609	1,009	543,292
Costs of sales	238,374	2,217	22,061	24,278	262,652
Maintenance	201,791	9,518	9,518	19,036	220,827
Advertising and publicity	180,394	3,498	1,551	5,049	185,443
Donated goods / services	133,331	2,063	10,699	12,762	146,093
Professional fees	89,318	12,277	13,837	26,114	115,432
Utilities	104,353	4,922	4,922	9,844	114,197
Production	81,775	18,016	-	18,016	99,791
Insurance	74,626	3,520	3,520	7,040	81,666
Telephone	48,183	6,643	7,487	14,130	62,313
Cultivation / hospitality	23,583	8,453	23,058	31,511	55,094
Repairs	42,839	2,020	2,020	4,040	46,879
Printing and publication	37,048	7,357	1,072	8,429	45,477
Transportation / vehicles	39,438	4,367	-	4,367	43,805
Supplies	34,512	1,628	1,628	3,256	37,768
Postage and shipping	12,089	1,353	17,843	19,196	31,285
Conferences, trainings, dues and subscriptions	21,304	7,188	1,663	8,851	30,155
Consulting fees	22,352	5,500	-	5,500	27,852
Travel	9,889	1,314	1,239	2,553	12,442
Property taxes	10,843	511	511	1,022	11,865
Office supplies	5,287	729	822	1,551	6,838
Miscellaneous, including bad debt expense	397	2,007	470	2,477	2,874
Depreciation	681,473	32,142	32,142	64,284	745,757
	<u>\$ 4,796,692</u>	<u>\$ 687,262</u>	<u>\$ 712,204</u>	<u>\$ 1,399,466</u>	<u>\$ 6,196,158</u>
Percentage of total	<u>77.4 %</u>	<u>11.1 %</u>	<u>11.2 %</u>	<u>22.6 %</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, 2017  
(With Comparative Totals for 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Change in net assets	\$ 97,022	\$ 1,656,810
Adjustments to reconcile change in net assets to net cash used in operating activities		
Depreciation	745,757	630,148
Net realized and unrealized gains on investments	(1,336,539)	(373,751)
Loss on disposal of property and equipment	-	23,630
Purchase of art collection	-	150,000
Contributions restricted for long-term purposes	(187,162)	(2,421,042)
Permanently restricted endowment contributions	(1,262,000)	(620,000)
Donated property and equipment	(59,625)	-
Changes in operating assets and liabilities		
Accounts receivable	(14,404)	12,601
Contributions receivable	960,383	818,671
Grants receivable	675,000	(288,025)
Prepaid expenses	11,140	(52,991)
Accounts payable	45,128	67,858
Accrued expenses	(23,922)	221,729
Deposits	(12,500)	11,000
Deferred revenue	(51,871)	105,992
Net cash used in operating activities	<u>(413,593)</u>	<u>(57,370)</u>
Cash flows from investing activities		
Purchases of property and equipment	(347,327)	(2,047,357)
Purchases of investments	(2,804,274)	(2,051,143)
Proceeds from sales of investments	1,958,039	1,402,309
Purchase of art collection	-	(150,000)
Net cash used in investing activities	<u>(1,193,562)</u>	<u>(2,846,191)</u>
Cash flows from financing activities		
Cash received and proceeds from sale of donated securities restricted for long-term purposes	187,162	2,421,042
Cash received from permanently restricted endowment contributions	1,262,000	620,000
Net cash provided by financing activities	<u>1,449,162</u>	<u>3,041,042</u>
Net increase (decrease) in cash and cash equivalents	(157,993)	137,481
Cash and cash equivalents, beginning of year	<u>815,801</u>	<u>678,320</u>
Cash and cash equivalents, end of year	<u>\$ 657,808</u>	<u>\$ 815,801</u>
Supplemental schedule of noncash investing and financing activities		
Contributions receivable collected by donated securities	\$ 50,000	\$ 446,174
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, 2017

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.

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.

Montalvo Association  
Notes to Financial Statements  
September 30, 2017

2. PROGRAMS (continued)

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.

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:

Montalvo Association  
Notes to Financial Statements  
September 30, 2017

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of accounting and financial statement presentation (continued)

- *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.
- *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.

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 an original 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.

Montalvo Association  
Notes to Financial Statements  
September 30, 2017

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributions and grants receivable

Unconditional promises to give expected to be collected in less than one year are recorded at their net realizable value which is a reasonable estimate of fair value. If such promises to give are due in more than one year, they are recognized at fair value based on the present value of their estimated future cash flows using a market rate discount. 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, 2017, 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.

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.

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.

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Notes to Financial Statements  
September 30, 2017

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.

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.

Montalvo Association  
Notes to Financial Statements  
September 30, 2017

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, 2017, \$427,985 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, 2017 totaled \$185,443.

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, 2017

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, 2017, 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, 2016, from which the summarized information was derived.

Subsequent events

Montalvo has evaluated subsequent events through January 25, 2018, 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, 2017

4. CONTRIBUTIONS AND GRANTS RECEIVABLE

Contributions and grants receivable consist of the following:

Due in less than one year	\$ 416,084
Due in one to five years	735,600
Due in more than five years	<u>190,000</u>
	1,341,684
Less: discount on multi-year contributions and grants receivable	<u>(68,191)</u>
	<u><u>\$ 1,273,493</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 as of September 30, 2017 ranged from 1.31% to 2.33%.

5. INVESTMENTS

The following table sets forth by level, within the fair value hierarchy, the Organization's assets measured at fair value:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 254,766	\$ -	\$ -	\$ 254,766
Fixed income	-	793,453	-	793,453
Exchange traded funds	791,831	-	-	791,831
Domestic equity funds	12,146,321	-	-	12,146,321
Domestic bond funds	<u>3,237,704</u>	<u>-</u>	<u>-</u>	<u>3,237,704</u>
	<u><u>\$ 16,430,622</u></u>	<u><u>\$ 793,453</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 17,224,075</u></u>

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6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Artist residency	\$ 8,642,846
Building improvements	5,521,827
Land improvements	2,762,149
Carriage house	1,381,332
Office equipment	754,553
Gallery	484,367
Furniture and fixtures	468,465
Vehicles	92,506
Land	53,000
Construction in progress	<u>210,501</u>
	20,371,546
Accumulated depreciation	<u>(11,451,872)</u>
	<u><u>\$ 8,919,674</u></u>

Depreciation and amortization expense for the year ended September 30, 2017 totaled \$745,757.

7. LINE OF CREDIT

At September 30, 2017, 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, 2017, 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, 2017, the interest rate was 4.25%.

8. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following:

Purpose restricted - capital projects	\$ 97,329
Purpose restricted - other	228,787
Time restricted	457,115
Accumulated endowment earnings	<u>685,090</u>
	<u><u>\$ 1,468,321</u></u>

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

Purpose restricted	\$ 587,002
Time restricted	416,200
Appropriated endowment earnings	<u>798,911</u>
	<u><u>\$ 1,802,113</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	6,495,841
General operations	2,051,257
Education	<u>348,808</u>
	<u>\$ 17,229,698</u>

As of September 30, 2017, approximately \$1,048,000 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.

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10. ENDOWMENT (continued)

Interpretation of relevant law (continued)

In accordance with the California version 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 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.

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.

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.

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10. ENDOWMENT (continued)

Endowment composition

Endowment net asset composition by type of fund as of September 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	<u>\$ -</u>	<u>\$ 685,090</u>	<u>\$ 17,229,698</u>	<u>\$ 17,914,788</u>

Changes in endowment net assets for the fiscal year ended September 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance, September 30, 2016	<u>\$ (317,688)</u>	<u>\$ -</u>	<u>\$ 17,288,533</u>	<u>\$ 16,970,845</u>
Investment return				
Interest and dividend income	-	468,111	-	468,111
Net realized and unrealized gains	<u>317,688</u>	<u>1,015,890</u>	<u>-</u>	<u>1,333,578</u>
Total investment return	317,688	1,484,001	-	1,801,689
Contributions	-	-	56,165	56,165
Appropriated investment earnings	-	(798,911)	-	(798,911)
Change in donor-imposed restriction	<u>-</u>	<u>-</u>	<u>(115,000)</u>	<u>(115,000)</u>
	<u>317,688</u>	<u>685,090</u>	<u>(58,835)</u>	<u>943,943</u>
Balance, September 30, 2017	<u>\$ -</u>	<u>\$ 685,090</u>	<u>\$ 17,229,698</u>	<u>\$ 17,914,788</u>

11. CONTRIBUTIONS IN-KIND

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

Contributions in-kind are as follows:

Donated property and equipment	\$ 59,300
Advertising	99,084
Wine	29,663
Other	<u>17,671</u>
	205,718
Special events	<u>82,251</u>
	<u>\$ 287,969</u>

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11. CONTRIBUTIONS IN-KIND (continued)

During the year ended September 30, 2017, 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, 2017, volunteers and the Montalvo Service Group contributed 21,791 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 \$564,387. 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 \$503,000 for the year ended September 30, 2017.

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 \$41,570 during the year ended September 30, 2017.

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, 2017, Montalvo received contributions totaling \$21,550, included as temporarily restricted contributions in the accompanying statement of activities, for the purpose of acquiring a collection item. Outstanding contributions receivable as of September 30, 2017 include \$25,000 promised to Montalvo for the purpose of acquiring the collection item. As of September 30, 2017, Montalvo 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.

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, 2017, cash of approximately \$41,076 was transferred by the MSG to Montalvo primarily for various facility repairs.