

Montalvo Association
(A California Nonprofit Public Benefit Corporation)

Financial Statements

For the Year Ended September 30, 2015
With Comparative Totals for the Year Ended September 30, 2014



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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, 2015, 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, 2015, 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 2014 financial statements, and our report dated January 26, 2015 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, 2014, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Armanino LLP

Armanino^{LLP}
San Ramon, California

January 26, 2016

MONTALVO ASSOCIATION
Statement of Financial Position
September 30, 2015
(With Comparative Totals for 2014)

<u>ASSETS</u>	<u>2015</u>	<u>2014</u>
Current assets		
Cash and cash equivalents	\$ 678,320	\$ 808,854
Accounts receivable	31,066	17,455
Current portion of pledges receivable	515,634	1,574,176
Current portion of grants receivable	531,975	678,333
Prepaid expenses	<u>134,282</u>	<u>169,624</u>
Total current assets	1,891,277	3,248,442
Investments	14,018,717	10,551,101
Pledges receivable, net of current portion	2,381,913	5,380,659
Grants receivable, net of current portion	10,000	-
Property and equipment, net	<u>7,864,899</u>	<u>8,113,255</u>
 Total assets	 <u>\$ 26,166,806</u>	 <u>\$ 27,293,457</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities		
Accounts payable	\$ 63,029	\$ 91,238
Accrued expenses	290,310	284,558
Deposits	42,000	39,041
Deferred revenue	<u>373,864</u>	<u>448,560</u>
Total current liabilities	<u>769,203</u>	<u>863,397</u>
Net assets		
Unrestricted net assets		
Montalvo Service Group	165,507	204,373
Unrestricted net assets	<u>6,894,464</u>	<u>8,028,919</u>
Total unrestricted net assets	7,059,971	8,233,292
Temporarily restricted net assets	1,061,391	1,121,391
Permanently restricted net assets	<u>17,276,241</u>	<u>17,075,377</u>
Total net assets	<u>25,397,603</u>	<u>26,430,060</u>
 Total liabilities and net assets	 <u>\$ 26,166,806</u>	 <u>\$ 27,293,457</u>

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

MONTALVO ASSOCIATION
Statement of Activities
For the Year Ended September 30, 2015
(With Comparative Totals for 2014)

	2015			2014	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Support and revenue					
Support					
Individuals	\$ 1,063,224	\$ 574,215	\$ 200,864	\$ 1,838,303	\$ 2,625,529
Grants and contributions	220,116	486,245	-	706,361	466,025
Contributions in-kind	174,008	-	-	174,008	651,503
Special events (includes in-kind contributions of \$60,379 and \$62,358)	527,498	-	-	527,498	831,204
Less: direct expenses	(129,541)	-	-	(129,541)	(280,851)
Total support	<u>1,855,305</u>	<u>1,060,460</u>	<u>200,864</u>	<u>3,116,629</u>	<u>4,293,410</u>
Revenue					
Rentals	1,034,140	-	-	1,034,140	802,375
Arts programs	843,615	-	-	843,615	790,513
Dividends and interest	37,245	580,147	-	617,392	447,832
Concessions and merchandise	209,651	-	-	209,651	152,656
Total revenue	<u>2,124,651</u>	<u>580,147</u>	<u>-</u>	<u>2,704,798</u>	<u>2,193,376</u>
Total support and revenue	3,979,956	1,640,607	200,864	5,821,427	6,486,786
Net assets released from restrictions	<u>1,205,898</u>	<u>(1,205,898)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total support, revenue and net assets released from restrictions	<u>5,185,854</u>	<u>434,709</u>	<u>200,864</u>	<u>5,821,427</u>	<u>6,486,786</u>
Expenses					
Program services	<u>4,176,824</u>	<u>-</u>	<u>-</u>	<u>4,176,824</u>	<u>4,386,697</u>
Supporting services					
Management and general	619,895	-	-	619,895	518,090
Fundraising	786,334	-	-	786,334	765,382
Total supporting services	<u>1,406,229</u>	<u>-</u>	<u>-</u>	<u>1,406,229</u>	<u>1,283,472</u>
Total expenses	<u>5,583,053</u>	<u>-</u>	<u>-</u>	<u>5,583,053</u>	<u>5,670,169</u>
Change in net assets before changes related to net realized and unrealized gain (loss) on investments	(397,199)	434,709	200,864	238,374	816,617
Net realized and unrealized gain (loss) on investments	<u>(776,122)</u>	<u>(494,709)</u>	<u>-</u>	<u>(1,270,831)</u>	<u>175,435</u>
Change in net assets	(1,173,321)	(60,000)	200,864	(1,032,457)	992,052
Net assets, beginning 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>
Net assets, end of year	<u>\$ 7,059,971</u>	<u>\$ 1,061,391</u>	<u>\$ 17,276,241</u>	<u>\$ 25,397,603</u>	<u>\$ 26,430,060</u>

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

MONTALVO ASSOCIATION
Statement of Functional Expenses
For the Year Ended September 30, 2015
(With Comparative Totals for 2014)

Expenses	Program Services	Supporting Services			Total	
		Management and General	Fundraising	Total	2015	2014
Salaries and wages	\$ 1,465,293	\$ 395,809	\$ 503,557	\$ 899,366	\$ 2,364,659	\$ 2,156,705
Payroll taxes and employee benefits	347,689	79,781	92,434	172,215	519,904	493,084
Total salaries and related expenses	1,812,982	475,590	595,991	1,071,581	2,884,563	2,649,789
Donated goods / services	121,321	4,000	28,678	32,678	153,999	620,111
Artist fees / hospitality	516,822	-	1,125	1,125	517,947	470,438
Advertising and publicity	158,822	395	819	1,214	160,036	119,630
Maintenance	155,788	16,278	6,758	23,036	178,824	147,913
Costs of sales	223,569	9,085	37,285	46,370	269,939	225,832
Production	84,704	2,506	125	2,631	87,335	82,136
Utilities	94,709	4,467	4,467	8,934	103,643	116,140
Printing and publication	38,172	8,213	7,165	15,378	53,550	59,643
Professional fees	88,282	13,448	17,195	30,643	118,925	135,442
Insurance	73,153	3,450	3,450	6,900	80,053	73,193
Supplies	44,536	2,587	2,587	5,174	49,710	33,539
Cultivation / hospitality	19,805	10,410	26,817	37,227	57,032	46,755
Transportation / vehicles	70,015	-	-	-	70,015	64,088
Consultants	14,080	15,953	3,850	19,803	33,883	19,488
Postage and shipping	16,890	3,745	13,221	16,966	33,856	27,850
Telephone	24,495	3,741	4,784	8,525	33,020	33,121
Conferences, training, dues, subscriptions	17,148	11,533	1,233	12,766	29,914	22,697
Repairs	39,560	1,866	1,866	3,732	43,292	21,693
Property tax	7,508	-	-	-	7,508	6,896
Office supplies	2,513	3,491	712	4,203	6,716	6,615
Travel	11,824	3,700	1,229	4,929	16,753	15,875
Miscellaneous, including bad debt expense	819	-	1,540	1,540	2,359	35,831
Total expenses before depreciation	3,637,517	594,458	760,897	1,355,355	4,992,872	5,034,715
Depreciation	539,307	25,437	25,437	50,874	590,181	635,454
Total functional expenses	\$ 4,176,824	\$ 619,895	\$ 786,334	\$ 1,406,229	\$ 5,583,053	\$ 5,670,169
Percentage of total	75%	11%	14%	25%	100%	

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

MONTALVO ASSOCIATION
Statement of Cash Flows
For the Year Ended September 30, 2015
(With Comparative Totals for 2014)

	2015	2014
Cash flows from operating activities		
Change in net assets	\$ (1,032,457)	\$ 992,052
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation	590,181	635,454
Net realized and unrealized (gain) loss on investments	1,270,831	(175,435)
Donated property and equipment	-	(31,392)
Contributions restricted for long-term purposes	(200,000)	(100,000)
Permanently restricted endowment contributions	(4,647,333)	(2,710,000)
Changes in operating assets and liabilities		
Accounts receivable	(13,611)	(2,064)
Pledges receivable	4,057,288	988,328
Grants receivable	136,358	148,745
Prepaid expenses	35,342	(62,936)
Accounts payable	(28,209)	56,451
Accrued expenses	5,752	26,839
Deposits	2,959	25,541
Deferred revenue	(74,696)	90,229
Net cash provided by (used in) operating activities	102,405	(118,188)
Cash flows from investing activities		
Purchases of property and equipment	(341,825)	(141,440)
Purchases of investments	(7,142,872)	(2,854,346)
Proceeds from sales of investments	2,404,425	528,678
Net cash used in investing activities	(5,080,272)	(2,467,108)
Cash flows from financing activities		
Cash received restricted for long-term purposes	200,000	100,000
Cash received from permanently restricted endowment contributions	745,052	1,520,584
Cash from sale of donated securities restricted for long term purposes	3,902,281	1,189,416
Net cash provided by financing activities	4,847,333	2,810,000
Net increase (decrease) in and cash equivalents	(130,534)	224,704
Cash and cash equivalents, beginning of year	808,854	584,150
Cash and cash equivalents, end of year	\$ 678,320	\$ 808,854
<u>Supplemental disclosure of non-cash investing activities</u>		
Pledges receivable collected by donated securities	\$ 3,902,281	\$ 1,189,416

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

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

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, 2015

2. Program Services (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, 2015

2. Program Services (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 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.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

3. Summary of Significant Accounting Policies (continued)

Basis of presentation (continued)

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.

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, 2014, from which the summarized information was derived.

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.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

3. Summary of Significant Accounting Policies (continued)

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, 2015, 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.

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.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

3. Summary of Significant Accounting Policies (continued)

Fair value measurements (continued)

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.

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, 2015

3. Summary of Significant Accounting Policies (continued)

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, 2015, \$373,864 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.

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.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

3. Summary of Significant Accounting Policies (continued)

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, 2015, 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, 2015 was \$160,036.

4. Pledges and Grants Receivable

Pledges and grants receivable consisted of the following at September 30, 2015:

Due in less than one year	\$1,067,609
Due in one to five years	1,980,000
Due in more than five years	<u>540,000</u>
Total	3,587,609
Less: discount on multi-year contributions and grants receivable	<u>(148,087)</u>
Contributions and grants receivable, net	3,439,522
Less: current portion	<u>(1,047,609)</u>
Contributions and grants receivable, noncurrent, net of discount	<u>\$2,391,913</u>

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, 2015 ranged from 0.10% to 2.64%.

As of September 30, 2015, Montalvo has conditional pledges outstanding totaling \$957,800. Pledges totaling \$457,800 were recognized subsequent to September 30, 2015 as the conditions were substantially met.

MONTALVO ASSOCIATION
Notes to Financial Statements
September 30, 2015

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, 2015 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	\$ 937,531	\$ -	\$ -	\$ 937,531
Domestic equity funds	8,855,083	-	-	8,855,083
Domestic bond funds	<u>4,226,103</u>	<u>-</u>	<u>-</u>	<u>4,226,103</u>
Total	<u>\$14,018,717</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$14,018,717</u>

6. Property and Equipment

The cost and related accumulated depreciation of property and equipment at September 30, 2015 consisted of the following:

Artists residency	\$ 8,633,511
Building improvements	5,400,370
Carriage house	1,292,124
Office equipment	748,462
Gallery	472,172
Furniture and fixtures	403,746
Land improvements	752,439
Construction in progress	115,068
Vehicles	92,506
Land	<u>53,000</u>
	17,963,398
Less: accumulated depreciation and amortization	<u>(10,098,499)</u>
Property and equipment, net	<u>\$ 7,864,899</u>

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, 2015 was \$590,181.

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7. Credit Facility

At September 30, 2015, Montalvo had an available line of credit to finance cash flow in the amount of \$500,000. The line of credit was renewed on July 16, 2015 for an additional twelve month period and is secured by certain Montalvo assets. At September 30, 2015, 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, 2015, the interest rate was 4.25%.

8. Temporarily Restricted Net Assets

Montalvo's temporarily restricted net assets consisted of the following as of September 30, 2015:

Purpose restrictions	
Capital projects	\$ 549,142
Other	63,017
Time restrictions	<u>449,232</u>
Total temporarily restricted net assets	<u>\$1,061,391</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, 2015 as follows:

Purpose restriction	\$ 381,087
Time restriction	403,791
Appropriated endowment earnings	<u>421,020</u>
Total net assets released from restrictions	<u>\$1,205,898</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, 2015:

Lucas Artists Program	\$ 8,333,792
Villa and grounds	6,542,384
General operations	2,051,257
Education	<u>348,808</u>
Total	<u>\$17,276,241</u>

As of September 30, 2015, \$2,863,176 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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Notes to Financial Statements
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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. 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 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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9. Endowment (continued)

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, 2015, the fair value of donor restricted endowment assets was approximately \$732,000 less than the permanently restricted net asset balance as of September 30, 2015.

Endowment net asset composition by type of fund as of September 30, 2015 is as follows:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$(732,815)	\$ -	\$17,276,241	<u>\$16,543,426</u>

Changes in endowment net assets for the year ended September 30, 2015:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -	\$ 335,582	\$17,075,377	\$17,410,959
Contributions	-	-	200,864	200,864
Dividends and interest	-	580,147	-	580,147
Net realized and unrealized losses	(732,815)	(494,709)	-	(1,227,524)
Appropriated investment earnings	-	(421,020)	-	(421,020)
Endowment net assets, end of year	<u>\$(732,815)</u>	<u>\$ -</u>	<u>\$17,276,241</u>	<u>\$16,543,426</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, 2015, the following in-kind contributions were received by Montalvo:

Special events	\$ 60,379
Other	<u>174,008</u>
Total contributions in-kind	<u>\$234,387</u>

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10. Contributions In-Kind (continued)

During the year ended September 30, 2015, 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, 2015, volunteers and the Montalvo Service Group contributed 20,724 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 \$511,468. 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 \$985,000 for the year ended September 30, 2015.

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. No contribution was made to this plan for the year ended September 30, 2015.

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, 2015, cash of approximately \$36,000 was transferred by the MSG to Montalvo primarily for various facility repairs.

14. Subsequent Events

Montalvo has evaluated subsequent events through January 26, 2016, the date the financial statements were available to be issued.