

Montalvo Association

Financial Statements

September 30, 2019
(With Comparative Totals for 2018)



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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), which comprise the statement of financial position as of September 30, 2019, 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, 2019, 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.

Change in Accounting Principle

As described in Note 3 to the financial statements, Montalvo Association has adopted ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to that matter.

Report on Summarized Comparative Information

We have previously audited Montalvo Association's 2018 financial statements, and our report dated January 25, 2019 expressed an unmodified opinion on those audited financial statements. As part of our audit of the 2019 financial statements, we also audited the adjustments to the 2018 financial statements to apply the change in accounting principle discussed above. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2018, adjusted for the change in accounting principle discussed above, is consistent, in all material respects, with the audited financial statements from which it has been derived. Also, in our opinion, such adjustments are appropriate and have been properly applied.



Armanino^{LLP}
San Jose, California

February 5, 2020

Montalvo Association
Statement of Financial Position
September 30, 2019
(With Comparative Totals for 2018)

	2019	2018
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,228,970	\$ 1,050,770
Accounts receivable	68,584	50,336
Current portion of contributions receivable	385,660	331,380
Current portion of grants receivable	450,000	145,000
Inventory	-	30,939
Prepaid expenses	207,985	630,486
Total current assets	2,341,199	2,238,911
Property and equipment, net	8,049,569	8,537,276
Other assets		
Investments	315,835	298,369
Investments held for endowment	16,530,134	16,914,611
Contributions receivable, net of current portion	607,544	742,142
Grants receivable, net of current portion	175,000	-
Other donated long-term assets	52,000	-
Collections (Note 14)	-	-
Total other assets	17,680,513	17,955,122
Total assets	\$ 28,071,281	\$ 28,731,309
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable	\$ 182,264	\$ 246,621
Accrued expenses	487,642	516,335
Deposits	35,500	42,500
Deferred revenue	478,004	442,688
Total current liabilities	1,183,410	1,248,144
Net assets		
Without donor restrictions		
Montalvo Service Group	365,865	316,631
Undesignated	7,931,886	8,215,089
Total without donor restrictions	8,297,751	8,531,720
With donor restrictions	18,590,120	18,951,445
Total net assets	26,887,871	27,483,165
Total liabilities and net assets	\$ 28,071,281	\$ 28,731,309

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

Montalvo Association
Statement of Activities
For the Year Ended September 30, 2019
(With Comparative Totals for 2018)

	Without Donor Restrictions	With Donor Restrictions	2019 Total	2018 Total
Support, revenue and gains (losses)				
Support				
Individuals	\$ 1,456,380	\$ 824,108	\$ 2,280,488	\$ 2,264,675
Grants and contributions	155,437	923,367	1,078,804	924,596
Contributions in-kind	136,139	-	136,139	135,746
Proceeds from special events	649,793	10,000	659,793	1,250,575
Special event direct donor benefits	(313,492)	-	(313,492)	(430,768)
Total support	2,084,257	1,757,475	3,841,732	4,144,824
Revenues and gains (losses)				
Rentals	1,135,953	-	1,135,953	1,076,008
Art programs	1,846,755	-	1,846,755	956,727
Net investment return	806	318,667	319,473	526,511
Concessions and merchandise	129,677	-	129,677	67,720
Gains (losses) on disposal of assets	-	-	-	(4,539)
Net assets released from restriction	2,391,195	(2,391,195)	-	-
Total revenues and gains (losses)	5,504,386	(2,072,528)	3,431,858	2,622,427
Total support, revenue and gains (losses)	7,588,643	(315,053)	7,273,590	6,767,251
Functional expenses				
Programs	5,476,473	-	5,476,473	4,356,478
Support services				
General & administrative	841,462	-	841,462	794,055
Marketing & promotion	580,434	-	580,434	441,275
Fundraising	924,243	-	924,243	843,713
Total support services	2,346,139	-	2,346,139	2,079,043
Total functional expenses	7,822,612	-	7,822,612	6,435,521
Change in net assets from operations	(233,969)	(315,053)	(549,022)	331,730
Non-operating income (losses)				
Collection item purchased but not capitalized (Note 14)	-	(46,272)	(46,272)	-
Change in net assets	(233,969)	(361,325)	(595,294)	331,730
Net assets, beginning of year	8,531,720	18,951,445	27,483,165	27,151,435
Net assets, end of year	\$ 8,297,751	\$ 18,590,120	\$ 26,887,871	\$ 27,483,165

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

Montalvo Association
Statement of Functional Expenses
For the Year Ended September 30, 2019
(With Comparative Totals for 2018)

	Support Services				Total Support Services	Cost of Direct Benefits to Donors	2019 Total	2018 Total
	Programs	General & Administrative	Marketing & Promotion	Fundraising				
Salaries and related expenses								
Salaries and wages	\$ 1,968,387	\$ 520,940	\$ 109,002	\$ 601,363	\$ 1,231,305	\$ -	\$ 3,199,692	\$ 2,960,864
Payroll taxes and benefits	439,176	62,681	27,072	133,741	223,494	-	662,670	611,108
Total salaries and related expenses	<u>2,407,563</u>	<u>583,621</u>	<u>136,074</u>	<u>735,104</u>	<u>1,454,799</u>	-	<u>3,862,362</u>	<u>3,571,972</u>
Artist fees / hospitality	1,014,426	-	-	1,012	1,012	-	1,015,438	600,148
Advertising	160,360	6,402	340,042	7,117	353,561	-	513,921	264,171
Maintenance	264,427	12,472	-	12,472	24,944	-	289,371	215,213
Costs of sales	235,256	116	-	-	116	-	235,372	166,022
Utilities	122,399	5,773	-	5,773	11,546	-	133,945	108,156
Production	106,814	14,195	-	675	14,870	-	121,684	81,437
Cultivation / hospitality	27,976	22,281	-	50,470	72,751	-	100,727	48,606
Insurance	91,003	4,292	-	4,292	8,584	-	99,587	82,906
Printing and publication	52,103	5,277	33,215	1,404	39,896	-	91,999	56,879
Donated goods / services	31,451	-	26,355	26,333	52,688	-	84,139	127,011
Consulting fees	31,610	400	44,748	2,100	47,248	-	78,858	37,539
Professional fees	12,750	54,698	-	2,778	57,476	-	70,226	61,524
Supplies	55,662	2,625	-	2,625	5,250	-	60,912	40,537
Repairs	3,123	54,938	-	-	54,938	-	58,061	29,101
Transportation / vehicles	34,765	19,352	-	1,899	21,251	-	56,016	22,665
Telephone	35,832	6,592	-	7,866	14,458	-	50,290	56,836
Conferences, trainings, dues and subscriptions	35,172	9,508	-	650	10,158	-	45,330	30,566
Postage and shipping	9,495	765	-	24,996	25,761	-	35,256	34,337
Travel	19,252	2,449	-	854	3,303	-	22,555	12,742
Property taxes	12,128	572	-	572	1,144	-	13,272	11,872
Meals and entertainment	-	-	-	-	-	313,492	313,492	430,768
Office supplies	6,594	1,213	-	1,448	2,661	-	9,255	6,632
Miscellaneous, including bad debt expense	57	610	-	492	1,102	-	1,159	10,012
Depreciation	<u>706,255</u>	<u>33,311</u>	<u>-</u>	<u>33,311</u>	<u>66,622</u>	<u>-</u>	<u>772,877</u>	<u>758,637</u>
Total expenses by function	5,476,473	841,462	580,434	924,243	2,346,139	313,492	8,136,104	6,866,289
Less expenses included with revenues on the statement of activities								
Cost of direct benefits to donors	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(313,492)</u>	<u>(313,492)</u>	<u>(430,768)</u>
Total expenses included in the expense section on the statement of activities	<u>\$ 5,476,473</u>	<u>\$ 841,462</u>	<u>\$ 580,434</u>	<u>\$ 924,243</u>	<u>\$ 2,346,139</u>	<u>\$ -</u>	<u>\$ 7,822,612</u>	<u>\$ 6,435,521</u>
Percentage of total	<u>70.0 %</u>	<u>10.8 %</u>	<u>7.4 %</u>	<u>11.8 %</u>	<u>30.0 %</u>	<u>-</u>	<u>100.0 %</u>	<u>-</u>

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

Montalvo Association
Statement of Cash Flows
For the Year Ended September 30, 2019
(With Comparative Totals for 2018)

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities		
Change in net assets	\$ (595,294)	\$ 331,730
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	772,877	758,637
Net realized and unrealized (gains) losses on investments	541,481	84,448
Loss on disposal of property and equipment	-	4,539
Contributions received and proceeds from immediate sale of donated securities for long-term purposes	(563,628)	(458,340)
Donated property and equipment	-	(8,794)
Donated other long-term assets	(52,000)	-
Changes in operating assets and liabilities		
Accounts receivable	(18,248)	(17,467)
Contributions receivable	80,318	44,971
Grants receivable	(480,000)	10,000
Inventory	30,939	(30,939)
Prepaid expenses	422,501	(454,353)
Accounts payable	(64,357)	70,606
Accrued expenses	(28,693)	28,218
Deposits	(7,000)	2,000
Deferred revenue	35,316	14,703
Net cash provided by operating activities	<u>74,212</u>	<u>379,959</u>
Cash flows from investing activities		
Purchases of property and equipment	(285,170)	(371,984)
Purchases of investments	(1,465,693)	(2,359,872)
Proceeds from sales of investments	<u>1,291,223</u>	<u>2,286,519</u>
Net cash used in investing activities	<u>(459,640)</u>	<u>(445,337)</u>
Cash flows from financing activities		
Contributions received and proceeds from immediate sale of donated securities for long-term purposes	<u>563,628</u>	<u>458,340</u>
Net cash provided by financing activities	<u>563,628</u>	<u>458,340</u>
Net increase in cash and cash equivalents	178,200	392,962
Cash and cash equivalents, beginning of year	<u>1,050,770</u>	<u>657,808</u>
Cash and cash equivalents, end of year	<u>\$ 1,228,970</u>	<u>\$ 1,050,770</u>

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

Montalvo Association
Notes to Financial Statements
September 30, 2019

1. NATURE OF OPERATIONS

Montalvo Association, (also known as "Villa Montalvo", "Montalvo Arts Center", "Montalvo", or the "Montalvo Association"), 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" or "Lucas Arts Program") 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 100+ 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.

From October 2018 to March 2019, Montalvo presented the West Coast debut of internationally renowned artist Bruce Munro in "Bruce Munro at Montalvo: Stories in Light". Featuring 10 light-based works, the exhibition represented the largest number of his works ever on view at a single venue, and welcomed 43,000 visitors.

Performing Arts Series

This vibrant interdisciplinary program consists of more than 40 concerts per year, presented in the intimate 300-seat Carriage House Theatre, the Main Hall of the historic Villa, and outdoors on Montalvo's scenic grounds.

Montalvo Association
Notes to Financial Statements
September 30, 2019

2. PROGRAMS (continued)

Exhibitions and Visual Arts Public Programming

Montalvo's visual arts program encompasses 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.

This year, the LAP commissioned the creation of four new works of art installed outdoors on Montalvo's grounds, which examined the threads of social fabric. These works were celebrated at a performance festival called "Threads: Weaving Humanity", which drew nearly 1,000 visitors to the property. The event featured collaborations with local performing groups who presented music and dance and engaged the public in participatory activities.

Beginning in June 2019, Montalvo offered outreach programs under the umbrella of "Montalvo Summer Nights". Events included "Sunset Cinema", a free movie-on-the-lawn series attended by over 1,000 patrons; dance and arts-practice workshops; and the annual art/astronomy summer arts festival, "Starry, Starry Night".

Education and Outreach

Montalvo's onsite 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 Performing Arts Series for Students, Master Classes taught by resident artists, professional development for teachers including the annual "Arts in Your Classroom" conference, and visual and performing arts camps. In addition, Montalvo's groundbreaking Teaching Artist Program brings professional teaching artists into Santa Clara County classrooms instructing and inspiring over 2,000 additional students each year.

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, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of accounting and financial statement presentation (continued)

- *Net assets without donor restrictions* - Net assets for use in general operations and not subject to donor-imposed restrictions. Net assets without donor restrictions may also include amounts designated by the Montalvo board for particular uses, however, as of September 30, 2019, there were no such board-designated net assets.
- *Net assets with donor restrictions* - Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. These donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity.

Revenues are reported as increases in net assets without restrictions unless use of the related asset is limited by donor-imposed restrictions. Montalvo recognizes support from net assets with donor restrictions when the restrictions imposed by the donors have been satisfied or expired. Expenses are reported as decreases in net assets without restrictions. Gains and losses on assets and liabilities are reported as increases or decreases in net assets without restrictions unless their use is restricted by explicit donor restriction or by law. Expirations of 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.

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.

Montalvo Association
Notes to Financial Statements
September 30, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributions and grants receivable (continued)

As of September 30, 2019, 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 if donated. 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 in marketable securities with readily determinable fair values are stated at fair value using quoted market prices in the statement of financial position. Alternative investments in partnerships and limited liability companies are valued using a unitized net asset value ("NAV") as reported by the general partners or fund managers. Net asset values are subject to uncertainty and therefore may differ from net realizable value. Net investment income or loss (including realized and unrealized gains and losses on investments, interest, dividends, and investment fees) is included in the statement of activities as an increase or decrease in unrestricted net assets unless the income or loss is restricted by donor or law.

Fair value measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an 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:

Montalvo Association
Notes to Financial Statements
September 30, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurements (continued)

- *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.

Deferred revenue

Montalvo receives payments during the year in advance for various performances and for park rental. As of September 30, 2019, \$478,004 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 services are recognized only 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.

Montalvo Association
Notes to Financial Statements
September 30, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2019 totaled \$513,921.

Collections

Collection items acquired either through purchase or donation are not capitalized. Purchases of collection items are recorded as decreases in net assets without donor restrictions if purchased with unrestricted assets and as decreases in net assets with donor restrictions 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.

Income tax status

Montalvo has tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and 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 is exempt from federal income taxes except on net income, if any, derived from unrelated businesses activities. The Montalvo Association holds alternative investments in certain partnership and limited liability companies that may generate unrelated business taxable income or loss.

Montalvo evaluated its current tax positions and has concluded that as of September 30, 2019, Montalvo does not have any significant uncertain tax positions for which a reserve or disclosure would be necessary.

Montalvo Association
Notes to Financial Statements
September 30, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

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

Summarized comparative financial information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. 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, 2018, from which the summarized information was derived.

Subsequent events

Montalvo has evaluated subsequent events through February 5, 2020, 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.

Change in accounting principle

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 makes certain improvements to current reporting requirements, including:

1. Reducing the classes of net assets from three (unrestricted, temporarily restricted, and permanently restricted) to two (with donor restrictions and without donor restrictions).
2. Enhancing disclosures about:
 - a. Amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions.
 - b. Composition of net assets with donor restrictions and how the restrictions affect the use of resources.
 - c. Qualitative information about management of liquid resources and quantitative information about the availability of liquid resources to meet cash needs for general expenditures within one year of the statement of financial position date.
 - d. Amounts of expenses by both their natural classification and their functional classification in one location as a separate statement or in the notes to the financial statements.

Montalvo Association
Notes to Financial Statements
September 30, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Change in accounting principle (continued)

- e. Methods used to allocate costs among program and support functions.
 - f. Underwater endowment funds.
3. Reporting investment return net of external and direct internal investment expenses.
 4. Use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset and reclassify any amounts from net assets with donor restrictions to net assets without donor restrictions for such long-lived assets that have been placed in service as of the beginning of the period of adoption (thus eliminating the current option to release the donor-imposed restriction over the estimated useful life of the acquired asset).

The amendments have been applied on a retrospective basis in 2019 with the option to omit the disclosures about liquidity and availability of resources for the prior year comparative period.

Reclassifications

Certain 2018 expenses have been reclassified between programs and marketing and promotion supporting services expense on the accompanying statement of activities to conform to the 2019 presentation.

4. CONTRIBUTIONS AND GRANTS RECEIVABLE

Contributions and grants receivable consisted of the following:

Due in less than one year	\$ 835,660
Due in one to five years	710,800
Due in more than five years	<u>110,000</u>
	1,656,460
Less: discount on multi-year contributions and grants receivable	<u>(38,256)</u>
	<u><u>\$ 1,618,204</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, 2019 ranged from 1.63% to 2.64%.

During the year ended September 30, 2019, the Organization received a conditional promise to give for \$1,000,000 from one individual donor to spend on capital improvements. The donor will match dollar-to-dollar once the Organization meets the fundraising goal of \$1,000,000. As of September 30, 2019, total funds raised under this conditional promise to give was \$53,050.

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5. INVESTMENTS

The Organization has investments with Beacon Pointe Advisors, LLC, the Organization's investment manager. In addition to marketable securities, which 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, the Organization also holds alternative investments in limited liability companies and partnerships.

During the year ended September 30, 2018, the Organization acquired a membership interest in Partners Group Private Equity (Master Fund), LLC ("Partners Group" or "the Fund"). The Fund generally seeks attractive long-term capital appreciation by investing in a diversified private equity portfolio. In particular, the Fund seeks to achieve its objective to earn superior risk-adjusted returns by systematically overweighing the vehicles, segments and opportunities that the Fund believes offer the most attractive relative value at a given point in time. Redemptions are not permitted during the life of the Fund. Consequently, members may not be able to liquidate their investment other than as a result of repurchases of units offered periodically by the Fund. As of September 30, 2019, the carrying value of investment in Partners Group was \$1,056,420. Partners Group (USA) Inc. serves as the Fund's manager. The Fund's financial statements are audited annually as of March 31 each year.

During the year ended September 30, 2018, the Organization acquired a limited partnership interest in Redwood-Kairos Real Estate Value Fund VI LP ("Redwood-Kairos" or "the Fund"). The Fund's strategy is to acquire, manage, improve, renovate, rehabilitate, repair, operate, hold for investment, and dispose of real estate related equity or debt investments. Real estate property types may include: multifamily (including student housing, senior housing, or manufactured housing), office and industrial buildings (including medical office), grocery and pharmacy anchored and convenience retail. In particular, the Fund seeks to achieve its objective by investing through different parts of the capital structure, including but not limited to: real estate fee, joint venture, preferred equity, mezzanine loans, and subordinate debt. Subject to limited exceptions, a limited partner may not sell, assign, or transfer any interest in the Fund without the prior written consent of the general partner, which may be given or withheld in the general partner's sole and absolute discretion. Further, a limited partner may not withdraw any amount from the Fund. As of September 30, 2019, the carrying value of investment in Redwood-Kairos was \$441,553. Kairos Investment Management Company, LLC serves as the Fund's manager. The Fund's financial statements are audited annually as of December 31 each year.

The fair value of the Organization's investments in both Partners Group and Redwood-Kairos are not readily determinable and are reported to the Organization by the fund managers at net asset value which the Organization uses as a practical expedient to fair value.

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5. INVESTMENTS (continued)

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	Fair Value
Money market funds	\$ 250,154	\$ -	\$ -	\$ 250,154
Fixed income	-	1,843,280	-	1,843,280
Exchange traded funds	889,542	-	-	889,542
Domestic equity funds	9,749,382	-	-	9,749,382
Domestic bond funds	2,615,638	-	-	2,615,638
	<u>\$ 13,504,716</u>	<u>\$ 1,843,280</u>	<u>\$ -</u>	15,347,996
* Investments measured at net asset value				1,497,973
				<u>\$ 16,845,969</u>

* The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the statement of financial position. The Organization's investments in Partners Group and Redwood-Kairos are measured at net asset value of the funds, therefore should not be categorized within the fair value hierarchy.

The following table lists information related to investments measured at fair value on a recurring basis using NAV as the practical expedient by major category:

Description	NAV in Funds	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Partners Group	\$ 1,056,420	N/A	Ineligible	N/A
Redwood-Kairos	\$ 441,553	\$ 379,500	Ineligible	N/A

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6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

Artist residency	\$ 8,793,668
Building improvements	5,724,769
Land improvements	2,854,200
Carriage house	1,568,998
Office equipment	877,515
Gallery	488,022
Furniture and fixtures	482,730
Land	53,000
Automobiles	31,547
Construction in progress	<u>7,350</u>
	20,881,799
Accumulated depreciation	<u>(12,832,230)</u>
	<u><u>\$ 8,049,569</u></u>

Depreciation expense for the year ended September 30, 2019 totaled \$772,877.

7. LINE OF CREDIT

At September 30, 2019, Montalvo had an available line of credit to finance cash flow in the amount of \$500,000. The line of credit matures in June 2020. During the year ended September 30, 2019, no interest expense was incurred and there was no outstanding balance on the line of credit as of September 30, 2019. The line of credit bears interest at the U.S. prime rate plus 1%. As of September 30, 2019, the interest rate was 6.00%.

8. NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions consisted of the following:

Time restricted contributions	\$ 545,427
Support for summer events	250,000
Support for capital projects	168,495
Support for other purposes	161,422
Support for art acquisition	79,615
Support for LAP	40,000
Support for education	31,000
Unappropriated endowment earnings	73,193
Endowment funds held in perpetuity	<u>17,240,968</u>
	<u><u>\$ 18,590,120</u></u>

As of September 30, 2019, \$740,891 of endowment net assets are included as contributions and grants receivable in the accompanying statement of financial position.

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9. NET ASSETS RELEASED FROM RESTRICTION

Net assets released from restriction during the year were as follows:

	2019
Support for Munro exhibit	\$ 673,091
Time restricted contributions	300,700
Support for summer events	184,317
Support for capital projects	171,195
Support for education	113,500
Support for LAP	101,000
Support for other purposes	47,392
Appropriation of endowment earnings	800,000
	\$ 2,391,195

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 endowment funds held in perpetuity (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 funds that is not classified as endowment funds held in perpetuity is classified as net assets subject to appropriation and spending policy 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 fiscal year, for the general budgetary purposes of Montalvo, 4%-6% of the twelve quarter rolling average asset value for the three year period prior to December of that fiscal year 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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Notes to Financial Statements
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10. ENDOWMENT (continued)

Endowment composition

Endowment net asset composition by type of fund as of September 30, 2019 was as follows:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Original donor-restricted amount required to be held in perpetuity	\$ -	\$ 17,240,968	\$ 17,240,968
Unappropriated earnings on endowment funds	<u>-</u>	<u>73,193</u>	<u>73,193</u>
	<u>\$ -</u>	<u>\$ 17,314,161</u>	<u>\$ 17,314,161</u>

Change in endowment net assets for the fiscal year ended September 30, 2019 was as follows:

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Balance, September 30, 2018	<u>\$ -</u>	<u>\$ 17,768,831</u>	<u>\$ 17,768,831</u>
Net investment return	<u>-</u>	<u>318,667</u>	<u>318,667</u>
Contributions	-	131,611	131,611
Appropriated investment earnings	-	(800,000)	(800,000)
Change in donor-imposed restriction	<u>-</u>	<u>(104,948)</u>	<u>(104,948)</u>
	<u>-</u>	<u>(454,670)</u>	<u>(454,670)</u>
Balance, September 30, 2019	<u>\$ -</u>	<u>\$ 17,314,161</u>	<u>\$ 17,314,161</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 were as follows:

Other donated long-term assets	\$	52,000
Wine		33,833
Advertising		26,355
Supplies		13,899
Other		<u>10,052</u>
		136,139
Special events		<u>70,457</u>
	<u>\$</u>	<u>206,596</u>

During the year ended September 30, 2019, 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, 2019, volunteers and the Montalvo Service Group contributed 23,680 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 \$647,648. In accordance with U.S. GAAP, the value of these services is not reflected in the financial statements.

12. RELATED PARTY

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 \$883,544 for the year ended September 30, 2019.

13. EMPLOYEE BENEFIT PLAN

During 2000, Montalvo established a defined contribution plan for all eligible employees who are 18 years or above and have completed three months of service. Montalvo was 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 \$51,339 during the year ended September 30, 2019.

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, 2019, Montalvo received contributions totaling \$96,600, included as contributions with donor restrictions in the accompanying statement of activities, for the purpose of acquiring and maintaining collection items. Montalvo acquired \$46,272 of collection items during the year ended September 30, 2019.

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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, 2019, cash of approximately \$65,356 was transferred by the MSG to Montalvo primarily for various facility repairs.

16. LIQUIDITY AND FUNDS AVAILABLE

As part of Montalvo's liquidity management, it structures its financial assets to be available as its general expenditures, liabilities, and other obligations come due. To meet liquidity needs, Montalvo has cash and investments available as well as a line of credit. Contributions, grants and other receivables that are considered current will be collected within one year from the date of the statement of financial position.

Long-term investments primarily include donor-restricted endowment funds. While some of Montalvo's long-term investments are subject to redemption restrictions making them unavailable for liquidation within one year, such funds are maintained within Montalvo's donor-restricted endowment portfolio and subject to Montalvo's endowment investment and spending policies. Montalvo's donor-restricted endowment net assets also include \$605,431 of contributions receivable as of September 30, 2019 expected to be collected beyond one year. As described in Note 10, Montalvo's Finance Committee may appropriate 4%-6% of the fair market value of endowment funds each year for general operating needs. Accordingly, Montalvo expects to appropriate approximately \$800,000 to support general operations during the fiscal year ended September 30, 2020.

Montalvo's financial assets available as of September 30, 2019 to meet general expenditures and other obligations as they become due for one year were as follows:

Financial assets	
Cash and cash equivalents	\$ 1,228,970
Accounts receivable	68,584
Contributions receivable	993,204
Grants receivable	625,000
Investments	<u>16,845,969</u>
	<u>19,761,727</u>
Less amounts unavailable to support general expenditures	
Cash held by MSG for Villa and Grounds	(202,129)
Long-term contributions receivable to support general expenditures	(155,000)
Donor-restricted endowment (less appropriation for fiscal year 2020)	<u>(16,514,161)</u>
	<u>(16,871,290)</u>
	<u>\$ 2,890,437</u>

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16. LIQUIDITY AND FUNDS AVAILABLE (continued)

In addition, Montalvo has an available line of credit of \$500,000 which may be used to supplement financial assets available for general expenditures.