

**SANTA BARBARA MUSEUM OF ART**

**JUNE 30, 2017**

FINANCIAL STATEMENTS



**BARTLETT, PRINGLE & WOLF, LLP**  
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

# SANTA BARBARA MUSEUM OF ART

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## INDEPENDENT AUDITOR'S REPORT

**To the Board of Trustees of  
Santa Barbara Museum of Art:**

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Santa Barbara Museum of Art, which comprise the statement of financial position as of June 30, 2017, the related statements of activities and changes in net assets 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 of 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 the Santa Barbara Museum of Art as of June 30, 2017 and the results of its operations 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 the Santa Barbara Museum of Art's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 17, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Bartlett, Pringh + Wolf, LLP*

Santa Barbara, California  
November 27, 2017

**SANTA BARBARA MUSEUM OF ART  
STATEMENT OF FINANCIAL POSITION  
June 30, 2017 and 2016**

<b><u>ASSETS</u></b>		
	2017	2016
<b>Assets</b>		
Cash and cash equivalents	\$ 3,677,887	\$ 3,983,271
Accounts receivable	12,647	7,518
Bequests and pledges receivable	7,912,245	4,610,038
Inventory	119,533	96,155
Prepaid expenses	557,191	958,358
Investments	58,645,993	54,364,172
Charitable remainder trusts and gift annuities	14,092,471	14,233,186
Buildings and equipment, net	19,325,192	14,411,367
 Total Assets	 \$ 104,343,159	 \$ 92,664,065
<b><u>LIABILITIES AND NET ASSETS</u></b>		
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 801,588	\$ 709,860
Deferred income	393,199	148,261
Note payable	1,090,271	1,113,868
Gift annuity liabilities	48,821	84,751
 Total Liabilities	 2,333,879	 2,056,740
<b>Net Assets</b>		
Unrestricted net assets	49,892,611	37,802,200
Temporarily restricted net assets	19,239,417	19,646,998
Permanently restricted net assets	32,877,252	33,158,127
 Total Net Assets	 102,009,280	 90,607,325
 Total Liabilities and Net Assets	 \$ 104,343,159	 \$ 92,664,065

*See accompanying notes*

**SANTA BARBARA MUSEUM OF ART**  
**STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**  
**For the Year Ended June 30, 2017**  
**With Comparative Totals for the Year Ended June 30, 2016**

	<b>Total Unrestricted Funds</b>	<b>Temporarily Restricted Funds</b>	<b>Permanently Restricted Funds</b>	<b>Total All Funds</b>	
				<b>2017</b>	<b>2016</b>
<b>Income</b>					
<b>Support and Revenue:</b>					
Admissions	\$ 94,858	\$ -	\$ -	\$ 94,858	\$ 101,269
Events, programs, classes and lectures	219,560	-	-	219,560	167,403
Membership income	725,369	-	-	725,369	703,631
Contributions and grants	1,442,912	8,629,085	306,321	10,378,318	5,240,759
Special events, net of event expenses of \$53,393 and \$69,132	13,403	-	-	13,403	68,508
Membership tours, net of tour expenses of \$1,222,652 and \$670,747	27,301	-	-	27,301	(20,421)
Museum store sales, net of store expenses of \$381,033 and \$364,169	(46,583)	-	-	(46,583)	(14,422)
Change in value of charitable trusts and gift annuities	-	340,354	(587,196)	(246,842)	150,731
Distributions from perpetual trusts	348,730	-	-	348,730	512,045
Investment income (loss), net	4,407,892	2,082,249	-	6,490,141	(2,813,693)
Exhibition and collection management income	52,022	-	-	52,022	112,856
Other income	90,612	-	-	90,612	107,700
<b>Total income</b>	<b>7,376,076</b>	<b>11,051,688</b>	<b>(280,875)</b>	<b>18,146,889</b>	<b>4,316,366</b>
Net assets released from restrictions	7,407,881	(7,407,881)	-	-	-
<b>Expenses</b>					
<b>Program:</b>					
Curatorial, collection management and exhibitions	2,231,041	-	-	2,231,041	2,308,299
Education, programs and outreach	1,150,901	-	-	1,150,901	1,165,796
Membership	130,950	-	-	130,950	119,964
Building services and security	1,905,739	-	-	1,905,739	2,069,339
<b>Total Program Expenses</b>	<b>5,418,631</b>	<b>-</b>	<b>-</b>	<b>5,418,631</b>	<b>5,663,398</b>
<b>Supporting Services:</b>					
Management and general	1,054,557	-	-	1,054,557	1,012,444
Fundraising and development	519,373	-	-	519,373	525,204
<b>Total Supporting Services</b>	<b>1,573,930</b>	<b>-</b>	<b>-</b>	<b>1,573,930</b>	<b>1,537,648</b>
<b>Total Expenses</b>	<b>6,992,561</b>	<b>-</b>	<b>-</b>	<b>6,992,561</b>	<b>7,201,046</b>
<b>Excess (Deficit) of Revenue, Gains and Other Support Over Expenses Before Other Changes in Net Assets</b>	<b>7,791,396</b>	<b>3,643,807</b>	<b>(280,875)</b>	<b>11,154,328</b>	<b>(2,884,680)</b>
<b>Other Changes in Net Assets:</b>					
Deaccessioning income	414,820	-	-	414,820	207,860
Acquisition of art	(167,193)	-	-	(167,193)	(330,721)
<b>Total Other Changes in Net Assets</b>	<b>247,627</b>	<b>-</b>	<b>-</b>	<b>247,627</b>	<b>(122,861)</b>
<b>Change in net assets</b>	<b>8,039,023</b>	<b>3,643,807</b>	<b>(280,875)</b>	<b>11,401,955</b>	<b>(3,007,541)</b>
Reclassification of net assets	4,051,388	(4,051,388)	-	-	-
Net assets, beginning of the year	37,802,200	19,646,998	33,158,127	90,607,325	93,614,866
<b>Net assets, end of year</b>	<b>\$ 49,892,611</b>	<b>\$ 19,239,417</b>	<b>\$ 32,877,252</b>	<b>\$ 102,009,280</b>	<b>\$ 90,607,325</b>

See accompanying notes

**SANTA BARBARA MUSEUM OF ART**  
**STATEMENT OF CASH FLOWS**  
**For the Years Ended June 30, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
Cash Flows From Operating Activities		
Change in net assets	\$ 11,401,955	\$ (3,007,541)
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	464,348	475,234
Net realized and unrealized (gain) and loss on investments	(4,524,444)	2,088,986
Non-cash change in value of charitable trusts and gift annuities	359,338	(26,934)
Changes in:		
Accounts receivable	(5,129)	(6,490)
Bequests and pledges receivable	(3,302,207)	714,166
Inventory	(23,378)	40,922
Prepaid expenses	401,167	(660,113)
Accounts payable and accrued expenses	91,728	(50,313)
Deferred revenue	244,938	28,519
Gift annuity liabilities	(35,930)	(780)
Net Cash Provided (Used) by Operating Activities	<u>5,072,386</u>	<u>(404,344)</u>
Cash Flows From Investing Activities		
Payments for equipment and building improvements	(5,378,173)	(2,805,213)
Proceeds from sale and maturities of investments	12,041,964	17,544,077
Purchases of investments	(11,799,341)	(14,916,868)
Net Cash Used by Investing Activities	<u>(5,135,550)</u>	<u>(178,004)</u>
Cash Flows From Financing Activities		
Payments on long-term debt	(23,597)	(22,366)
Payments to gift annuitants	(218,623)	(23,581)
Net Cash Used by Financing Activities	<u>(242,220)</u>	<u>(45,947)</u>
Decrease in cash and cash equivalents	(305,384)	(628,295)
Cash and cash equivalents, beginning of year	<u>3,983,271</u>	<u>4,611,566</u>
Cash and cash equivalents, end of year	<u>\$ 3,677,887</u>	<u>\$ 3,983,271</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the year for interest	<u>\$ 48,855</u>	<u>\$ 50,086</u>

*See accompanying notes*

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Nature of Organization**

The Santa Barbara Museum of Art (the "Museum") is a California non-profit corporation founded in 1941 to collect, exhibit and interpret works of art and organize diverse exhibitions and programs to enhance public knowledge and appreciation of art. The mission of the Santa Barbara Museum of Art is to integrate art into the lives of people. The Museum believes in the power of art to ignite imagination, stimulate thought and generate experiences that are personally rewarding.

Recognizing that art museums play a constructive role in society, the Museum is committed to:

- Serve and educate the public.
- Champion a breadth of artistic expression.
- Enhance quality of life in the community.
- Accomplish these through the collection, research, preservation, and exhibition of works of art and the advancement of knowledge about them.
- Succeed as an organization through effective interdependence, collaboration and innovation.

The Museum's collection is comprised of approximately 24,000 works of art which span 5,000 years of human creativity and includes classical antiquities and masterpieces of French Impressionism. The Museum's collection of the arts of Asia, Europe and the Americas includes paintings, sculpture, prints, drawings, photographs, ceramics, glass, jades, bronzes, lacquer and textiles.

In addition to displaying its permanent collection, the Museum hosts special exhibitions, some traveling from other museums and some originated by its own curators. Its own exhibitions are often accompanied by scholarly catalogues and from time to time travel to other museums. The Museum has approximately 3,000 members, largely from the Santa Barbara area. Annual attendance at the Museum averages over 70,000 visitors.

The Museum brings people and art together through a broad array of formal and informal learning opportunities for all ages, both in the Museum and out in the community. The Museum provides more than twenty art education programs to over 40,000 people annually. These include academic, outreach and after school programs for K-twelfth-grade students, activities and events for families, classes for college students and lifelong learning opportunities for adults and seniors. In addition, the Museum regularly organizes and hosts lectures, symposia, film series, and focused gallery tours for the Museum's major exhibitions. Many of these programs involve collaborations with community organizations, schools and teachers, colleges and universities as well as selected artists.



**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Summary of Significant Accounting Policies**

Basis of Accounting

The accompanying financial statements of the Museum are prepared using the accrual basis of accounting.

Classification of Net Assets

The Museum reports information regarding its financial position and activities in three classes of net assets - unrestricted, temporarily restricted, and permanently restricted - based on the existence or absence of donor-imposed restrictions.

*Unrestricted net assets* consist of funds without any donor-imposed restrictions and are classified as either undesignated funds or Board-designated funds. Board-designated funds are then broken into four categories: the support group funds, the art funds, the quasi-endowment funds and the capital fund.

- The support group funds include resources of certain groups (Women's Board, The Museum Contemporaries, Dead Artists Society, Friends of Asian Art, and Photo Futures, among others) which act to further the interests of the Museum.
- The art funds include funds that the Board of Trustees has set aside for the purchase of art.
- The quasi-endowment funds consist of funds that the Board of Trustees, rather than a donor, has determined are to be maintained intact as investments to generate operating income.
- The capital fund includes fixed assets and funds designated for the acquisition of fixed assets.

*Temporarily restricted net assets* consist of contributions and other inflows of funds temporarily subject to donor-imposed restrictions. The restrictions are temporary in that they are expected to expire with the passage of time, be satisfied by actions of the Museum that fulfill donor stipulations, or apply to funds that are appropriated by the Board of Trustees for expenditure.

*Permanently restricted net assets* consist of contributions and other inflows of funds subject to donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Museum. Permanently restricted funds are sub-classified as art acquisition funds or endowment funds. Earnings from art acquisition funds are available only for the acquisition of art. Earnings from endowment funds are available to support either specific activities or general operations, in accordance with donor stipulations.

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Summary of Significant Accounting Policies (continued)**

Revenue

The Museum records membership dues as revenue when such income is received. Legally enforceable pledges, less an allowance for uncollectible amounts (if deemed necessary), are recorded as a receivable in the year made.

Income Taxes

The Museum is exempt from federal and state income taxes under Internal Revenue Code Section 501(c)(3) and Section 23701(d) of the California Revenue and Taxation Code; therefore, no provision for income taxes has been made. The Museum has not been classified as a private foundation.

The Museum evaluates uncertain tax positions, whereby the effect of the uncertainty would be recorded if the outcome was considered probable and reasonably estimable. As of June 30, 2017, the Museum had no uncertain tax positions requiring disclosure or accrual.

The Museum files tax returns in California and U.S. federal jurisdictions. The Museum is no longer subject to U.S federal and state examinations by tax authorities for years ending before 2012.

Investments

The Museum records investments in debt and equity securities with readily determinable market values at fair value. The fair value of investments in securities traded on national securities exchanges is valued at the closing price on the last business day of the year. The investments in hedge funds, partnerships and private equity, for which quoted market prices are not readily available, are determined by management in good faith with the assistance of third-party investment managers using methods it considers appropriate. The cost bases in alternative investments are adjusted for partnership activity estimated by the general partners. Realized and unrealized gains and losses are included in the change in net assets.

Financial Instruments

Financial instruments are carried at cost which approximates fair value.

Cash and Cash Equivalents

The Museum classifies its unrestricted short-term, highly liquid investments having original maturities of three months or less as cash equivalents, except for cash which is held by investment portfolio managers until suitable long-term investments are identified.

**SANTA BARBARA MUSEUM OF ART  
NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Summary of Significant Accounting Policies (continued)**

Inventory

Inventory consists of goods held for sale in the Museum store and is carried at the lower of cost (first-in, first-out method) or market.

Buildings and Equipment

Buildings and equipment are recorded at cost if purchased or at fair market value at time of contribution if donated. Depreciation and amortization expense are computed using the straight-line method over the lesser of the useful lives of the assets or the term of the related lease agreement. Depreciable lives of the assets range from 5 to 40 years. In general, the Museum capitalizes fixed assets with a cost of \$1,500 or more and with an expected life of greater than one year.

Exhibitions

The Museum records all contributions for future exhibitions as temporarily restricted revenue and all expenditures for future exhibitions as prepaid expenses. The revenue and expenses are recognized in the year the exhibition begins.

Contributed Services

A substantial number of volunteers have donated their time to the Museum as docents, board members and in auxiliary organizations. As this volunteer service does not meet the recognition requirements of accounting principles generally accepted in the United States of America, no amounts have been recognized in the accompanying statement of activities.

Contributions

Contributions are recorded as unrestricted unless the donor stipulates any restrictions. Donor-restricted contributions are recorded as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets. Donated marketable securities are recorded at fair market value on the date of donation.

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Summary of Significant Accounting Policies (continued)**

Collections

In conformity with the practice followed by art museums, art objects purchased or donated are not included in the accompanying statement of financial position. The Museum maintains a comprehensive fine arts collection. The collection is used for the purposes of exhibition, education, study, research, publications and loans to other museums. The collection is kept under curatorial care including extensive conservation practices and specialized fine arts insurance coverage, and is subject to the Museum's policy that requires proceeds from the sale of collection items to be used only for artwork. The Museum does not recognize donated collection items as contribution income as its collections are not capitalized.

Functional Expenses

The Museum allocates its expenses on a functional basis among its various program, management and general, and fundraising expenses. Expenses that can be identified with a specific area are allocated directly according to their natural expenditure classification. Other expenses that are common to several functions are allocated by various statistical bases.

Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires the use of estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenue and expenses. Significant estimates used in preparing these financial statements include:

- Lives of fixed assets and method of depreciation.
- Net present value of income interest in trusts and future annuities payable by charitable and gift annuity trusts.
- Fair market values of assets held by charitable trusts.
- Fair market value of certain investments.
- Allowance for uncollectible and discount factors used in determining present values of contributions receivable.
- Allocation of expenses to various program and support service categories.
- Uncertain tax positions.

It is at least reasonably possible that these estimates could change in the coming year.

**SANTA BARBARA MUSEUM OF ART  
NOTES TO FINANCIAL STATEMENTS**

**Note 2 - Summary of Significant Accounting Policies (continued)**

Comparative Amounts

The amounts shown for the year ended June 30, 2016, in the accompanying financial statements are included to provide a basis for comparison with June 30, 2017, and are not intended to present all information necessary for a fair presentation of the June 30, 2016 financial statements in conformity with accounting principles generally accepted in the United States of America.

**Note 3 - Bequests and Pledges Receivable**

Unconditional promises to give are included in the financial statements as receivables and revenue of the appropriate net asset category. As of June 30, 2017, the Museum has total bequests and pledges receivable of \$7,912,245. Management expects no material write-offs for receivables at June 30, 2017; therefore, no current provision has been made. These pledges and bequests are expected to be collected as follows:

Less than one year	\$	2,872,210
One to five years		<u>5,040,035</u>
Total bequests and pledges receivable	\$	<u><u>7,912,245</u></u>

See also Note 19.

**Note 4 - Investments**

Investments consist of the following at June 30, 2017:

	<u>Cost</u>	<u>Market</u>
Marketable Securities:		
Cash equivalents	\$ 4,675,180	\$ 4,675,180
Common stocks	7,866,272	10,006,028
Fixed income securities	192,756	217,434
Stock mutual funds	23,138,503	26,823,651
Bond mutual funds	<u>6,156,514</u>	<u>6,321,214</u>
Total Marketable Securities	42,029,225	48,043,507
Alternative Investments	<u>10,602,486</u>	<u>10,602,486</u>
Total Investments	<u><u>\$ 52,631,711</u></u>	<u><u>\$ 58,645,993</u></u>
Unrealized gain as of June 30, 2017		6,014,281
Unrealized gain as of June 30, 2016		<u>2,475,211</u>
Changes in unrealized gains		<u><u>\$ 3,539,070</u></u>

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 4 - Investments (continued)**

The market values of marketable securities are from quoted prices as of June 30, 2017, and the market value of alternative investment partnerships are provided by the general partners. These amounts are not necessarily indicative of the amounts the Museum could realize in a current market exchange. At June 30, 2017, the Museum had remaining investment commitments to alternative investment partnerships that are not readily marketable in an amount not to exceed \$2,323,604. Dividend and interest income and unrealized gains and losses not designated for support of the Museum's operations are allocated to participating funds based upon each fund's respective percentage participation in the Museum's investment pool.

The Board of Trustees has adopted a "total return" methodology for providing operating support to the Museum's Operating Fund. This annual draw is calculated as 4.95% of the five-year moving average of the fair market value of the endowment investment funds as of December 31.

The net investment gain for the year ended June 30, 2017 consists of:

Interest and dividends	\$ 769,085
Net realized gains	985,374
Partnership income	1,389,442
Net change in unrealized gains	3,539,070
Less investment expenses	<u>(192,830)</u>
Net investment income	<u>\$ 6,490,141</u>

**Note 5 - Fair Value Measurement**

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurement and Disclosures, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes inputs to the valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; discounted cash flows; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 5 - Fair Value Measurement (continued)**

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Investments that are included in this category generally include privately held investments and securities held in partnership format.

The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value.

Money market funds:	Money market funds valued at the net asset value (NAV) of shares held at year end.
Common stocks, fixed income, and mutual funds:	Exchange traded securities, mutual funds, and highly-liquid government bonds valued at quoted market prices or NAV of shares held as of year-end.
Charitable trust agreements and gift annuities:	Valued at estimated net present value (NPV) of beneficial interest in trust.
Partnerships:	Estimated by management and general partners in the absence of readily determinable fair values.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Museum believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

**SANTA BARBARA MUSEUM OF ART  
NOTES TO FINANCIAL STATEMENTS**

**Note 5 - Fair Value Measurement (continued)**

The following table sets forth by level within the fair value hierarchy the assets at fair values as of June 30, 2017:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Money market	\$ 4,675,180	\$ -	\$ -	\$ 4,675,180
Common stocks	10,006,028	-	-	10,006,028
Fixed income	217,434	-	-	217,434
Stock mutual funds	26,823,651	-	-	26,823,651
Bond mutual funds	6,321,214	-	-	6,321,214
Partnerships	-	-	10,602,486	10,602,486
Total Investments	48,043,507	-	10,602,486	58,645,993
Charitable trust agreements and gift annuities	-	14,092,471	-	14,092,471
Total assets measured at fair value	<u>\$ 48,043,507</u>	<u>\$ 14,092,471</u>	<u>\$ 10,602,486</u>	<u>\$ 72,738,464</u>

The following table provides a reconciliation of assets measured at fair value using significant unobservable inputs (Level 3) during the year ended June 30, 2017:

Balance, beginning of year	\$ 14,088,171
Partnership gain	1,389,442
Purchases and issuances	186,229
Sales and settlements	<u>(5,061,356)</u>
Balance, end of year	<u>\$ 10,602,486</u>

**Note 6 - Gift Annuities**

The Museum has entered into charitable gift annuity agreements. Pursuant to the agreements, the Museum received a charitable gift of marketable securities and is obligated to make annual payments for the remainder of the donor's life. The asset was originally recorded at fair market value on the date of creation. The liability is recorded at present value of future payments.



**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 6 - Gift Annuities (continued)**

The assets for the annuities are physically and legally segregated from other assets of the Museum pursuant to the California Insurance Code. The California Department of Insurance Regulations requires that no more than 50% of these segregated assets be invested in stock. The Museum has its gift annuities currently invested in a balanced index fund.

**Note 7 - Charitable Trust Agreements**

Charitable trust agreements in which the Museum has been named as an irrevocable beneficiary are recorded on the books of the Museum. If the Museum is the trustee, the fair market value of the trust is recorded in the Museum's statement of financial position and a corresponding liability is recorded for the net present value of the required payments as specified in the agreement. A contribution is recorded for the difference between the two amounts. If the Museum is not the trustee, the trust is recorded as a contribution and an asset equivalent to the present value of the trust assets and the estimated future income net of the present value of the estimated future payments to other beneficiaries.

Any change in subsequent years in the present value of the estimated future benefits to be received when the trust assets will be distributed is recorded in the Statement of Activities as a change in the value of charitable remainder trusts.

Charitable trust agreements are classified as temporarily restricted net assets unless the donor has permanently restricted the Museum's use of its interest in the asset.

The assets are recorded at approximate fair market value based upon the most recent tax return filed by the trust that is available to the Museum or current values provided by the trustee to the Museum. The present value of the estimated future value to be received by the Museum is calculated using the IRS annuity tables and a discount rate of 5%, based on the Museum's historic risk-free rate of return.

**Note 8 - Perpetual Income Trust Interests**

The Museum is named as an income beneficiary of four perpetual trusts, the corpus of which is not controlled by the management of the Museum. Under these arrangements, the Museum has the irrevocable right to receive income earned on the underlying assets held in perpetuity. Income received from three of the trusts is discretionary, while income from one trust is restricted for reimbursement of Asian art expenditures.

**SANTA BARBARA MUSEUM OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 8 - Perpetual Income Trust Interests (continued)**

For the four discretionary trusts, the Museum is a beneficiary of this stream of income in perpetuity. The Museum estimates the asset values by present valuing the five year average income distribution in perpetuity. Any change in the estimate of the asset values based upon the present value calculation is recorded in the Statement of Activities as a change in value of interests in trusts.

**Note 9 - Buildings and Equipment**

At June 30, 2017, the cost of buildings and equipment , net of accumulated depreciation was as follows:

Buildings and improvements	\$ 19,882,171
Construction in progress	13,761,469
Furniture and equipment	<u>4,014,371</u>
Total cost	37,658,011
Less accumulated depreciation	<u>(18,332,819)</u>
Buildings and equipment, net	<u><u>\$ 19,325,192</u></u>

Depreciation expense for the year ended June 30, 2017 was \$464,348.

In 1982, the Museum deeded certain parcels of privately held land to the County of Santa Barbara in exchange for a lease agreement with the County. The original Museum building and the Park Wing addition is currently leased by the Museum from the County at no cost until March 2081. Two separate buildings have been constructed on the adjacent parcels. The buildings are physically integrated and operated as a single facility. An agreement exists between the Museum and the County addressing the separation of the two buildings, including reversion of improvements to the County, should integrated use of the two structures ever change. The lease agreement is valued at the recorded amount of the land at the time of conveyance, and no gain or loss has been recognized in the transaction. The leasehold is being amortized over a 40-year period.

Buildings and equipment include one residence which is pledged as collateral on a note payable of \$1,090,271.

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**Note 10 - Note Payable**

The Museum has a note payable of \$1,090,271 secured by residential real estate at an interest rate of 4.375%. Payments of \$6,038 are due monthly with the final payment being due on May 15, 2042.

Principal payments are due as follows for the years ending June 30:

2018	\$	24,581
2019		25,694
2020		26,732
2021		28,068
2022		29,338
Thereafter		<u>955,858</u>
Total	\$	<u><u>1,090,271</u></u>

The Museum paid \$48,855 in interest for the year ended June 30, 2017.

**Note 11 - Deferred Revenue**

Deferred revenue consists of money received in advance for member tours and for summer art classes that will take place after June 30, 2017.

**Note 12 - Benefit Plan**

Museum employees who work at least 20 hours per week are eligible immediately to participate in a deferred salary savings plan under Section 403(b) of the Internal Revenue Code. For eligible employees with more than one year of service and participating in the 403(b) deferred salary savings plan, the Museum matches the employee's contribution up to 5% of the participant's compensation. Total Museum match for the plan during the year ended June 30, 2017 was \$108,381.

**Note 13 - Unemployment Benefits**

The Museum is self-insured against claims filed with the state employment department by former employees for unemployment benefits.

The Museum was refunded claims totaling \$431 during the year ended June 30, 2017.

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**Note 14 - Concentration of Risk**

Credit Risk

The Museum maintains cash balances at several banks insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At June 30, 2017, the Museum had approximately \$3,410,000 of cash deposits in excess of FDIC limits.

Investment Risk

The Museum holds its investments in a diversified portfolio. Nevertheless, these investments are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the financial statements.

Geographical Concentration

The Museum's membership and donor base is largely drawn from Santa Barbara County. Visitors are both local and tourists.

**Note 15 - Operating Leases**

The Museum leases various office equipment under non-cancellable operating leases through June 2022. Minimum rental payments under the terms of these leases are as follows for the year ending June 30:

2018	\$	40,909
2019		40,909
2020		11,529
2021		5,653
2022		2,827
Total	\$	<u>101,827</u>

Lease expense for the year ended June 30, 2017 totaled \$44,649.

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**Note 16 - Net Assets Released from Restriction**

Net assets were released from donor restrictions by satisfying the restricted purposes specified by donors or by appropriation by the Board of Trustees for expenditure. For the year ended June 30, 2017, the passage of time or expenditures fulfilling restricted purposes resulted in net assets released from restriction of \$7,407,881.

**Note 17 - Net Assets**

Unrestricted net assets consist of funds without any donor-imposed restrictions and are classified as either undesignated funds or Board-designated funds. Unrestricted net assets as of June 30, 2017, are as follows:

General unrestricted	\$ 21,930,719
Donor-restricted endowment deficit	(1,054,948)
Board-designated funds	
Conservation	1,745,876
Education	374,438
Art acquisition	983,476
General operations	<u>25,913,050</u>
Total Board-designated funds	<u>29,016,840</u>
Total unrestricted net assets	<u><u>\$ 49,892,611</u></u>

Temporarily restricted net assets consist of contributions and other inflows of funds temporarily subject to donor-imposed restrictions. The restrictions are temporary in that they are expected to expire with the passage of time or be satisfied and removed by the actions of the Museum that fulfill donor stipulations. Temporarily restricted net assets as of June 30, 2017, are as follows:

Bequests and pledges receivable	\$ 7,682,245
Split interest agreements	7,161,938
Donations with time restrictions	859,338
Un-appropriated earnings on endowments	<u>3,535,896</u>
Total temporarily restricted net assets	<u><u>\$ 19,239,417</u></u>

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**Note 17 - Net Assets (continued)**

Permanently restricted net assets consist of contributions and other inflows of funds subject to donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Museum. Endowment funds are invested to provide income to support specific activities or general operations, in accordance with donor stipulations. Permanently restricted net assets as of June 30, 2017, are as follows:

Pledges receivable	\$ 150,000
Perpetual interest trusts and split interest agreements	6,930,533
Donor-restricted endowment funds	<u>25,796,719</u>
Total permanently restricted net assets	<u>\$ 32,877,252</u>

**Note 18 - Endowment Funds**

The Museum's endowment consists of 64 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including those designated by Board of Trustees, are classified and reported based on the existence or absence of donor-imposed restrictions.

**Interpretation of Relevant Law**

The Board of Trustees has interpreted the California adopted Universal 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, the Museum classified as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the 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 the Museum in a manner consistent with the standard for prudence prescribed by UPMIFA.

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**Note 18 - Endowment Funds (continued)**

In accordance with California UPMIFA, the Museum 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 Museum 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 the Museum.
- (7) The investment policies of the Museum.

Endowment net assets are composed of the following as of June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted	\$ (1,054,948)	\$ 3,535,896	\$ 25,796,719	\$ 28,277,667
Board-restricted	30,071,788	-	-	30,071,788
Total	<u>\$ 29,016,840</u>	<u>\$ 3,535,896</u>	<u>\$ 25,796,719</u>	<u>\$ 58,349,455</u>

Changes in endowment net assets for the year ended June 30, 2017 are:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment of net assets, beginning of year	\$ 26,316,423	\$ 2,092,981	\$ 25,636,268	\$ 54,045,672
Net investment return (investment income, realized and unrealized gains and losses)	4,401,281	2,087,379	-	6,488,660
Contributions	499,785	-	160,451	660,236
Appropriations of endowment assets for expenditure	<u>(2,200,649)</u>	<u>(644,464)</u>	<u>-</u>	<u>(2,845,113)</u>
Endowment of net assets, end of year	<u>\$ 29,016,840</u>	<u>\$ 3,535,896</u>	<u>\$ 25,796,719</u>	<u>\$ 58,349,455</u>

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**Note 18 - Endowment Funds (continued)**

Return Objectives and Risk Parameters

The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity for donor-specified periods as well as Board-designated funds. The endowment assets are invested in a manner that is intended to produce results that provide a reasonable balance between the quest for growth and the need to protect principal. The investment policy calls for a diverse portfolio utilizing various asset classes with a goal of reducing volatility and risk. The Museum expects its endowment funds, over time, to provide an average rate of return of approximately 6.50% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Goals

To satisfy its long-term rate-of-return objectives, the Museum relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Museum targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objective within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Museum has a policy of appropriating for expenditure each year an amount not to exceed 4.95% of the five-year moving average fair value of the endowment fund investments as of December 31. In establishing this policy, the Museum considered the long-term expected return on its endowment. Accordingly, over the long-term, the Museum expects the current spending policy to allow its endowment to grow at an average of 1.5% annually. This is consistent with the Museum's objective to maintain the purchasing power of the endowment assets held in perpetuity for a specified term as well as to provide additional real growth through new gifts and investment return.

Endowment Funds with Deficiencies

From time to time, the fair value of the assets associated with individual donor-restricted funds may fall below the level that current law requires the Museum to retain for a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, these deficiencies are reported as a reduction in unrestricted net assets. Such deficiencies may result from unfavorable market fluctuations. As of June 30, 2017, endowment fund deficiencies totaled \$1,054,948.



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**Note 19 - Capital Campaign**

In 2012, the Museum entered into a capital campaign to assist with the cost of the renovation of its facilities. The fundraising goal of the campaign is \$50 million. As of June 30, 2017, approximately \$24 million has been raised. Many of the account balances presented in the financial statements reflect an increased level of activity resulting from the capital campaign and the renovation.

**Note 20 - Commitments**

The Museum has entered into a construction contract with Diani Building Corporation for the Museum renovation project in the amount of \$27,000,000.

The Museum has entered into an \$8,000,000 revolving line of credit agreement with U.S. Bank. Under the terms of the agreement, the Museum may draw on the line of credit to fund costs associated with its renovation project. Interest is payable monthly at LIBOR plus 1.50%. The line of credit is secured by the publicly traded securities in the Museum's investment account held at U.S. Bank. The line of credit matures on March 7, 2018, at which time all outstanding principal and interest is due. No amounts have been drawn on the line of credit at June 30, 2017.

**Note 21 - Reclassification**

Reclassifications were made between temporarily restricted and unrestricted net asset classes in order to reflect donor restrictions that had been previously satisfied.

**Note 22 - Subsequent Events**

Management has evaluated subsequent events through November 27, 2017, which is the date the financial statements were available to be issued pending final approval of the Board of Trustees. Management has determined no subsequent events requiring disclosure or significantly impacting disclosure have occurred.