

SANTA BARBARA MUSEUM OF ART

JUNE 30, 2019

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, 2019, the related statements of activities and changes in net assets, 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 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, 2019 and the results of its operations, functional expenses 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 2018 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 16, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2018, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Bartlett, Prungh & Wolf, LLP

Santa Barbara, California
November 21, 2019

**SANTA BARBARA MUSEUM OF ART
STATEMENT OF FINANCIAL POSITION
June 30, 2019 and 2018**

<u>ASSETS</u>		
	2019	2018
Assets		
Cash and cash equivalents	\$ 3,184,321	\$ 5,602,298
Accounts receivable	1,084	15,707
Bequests and pledges receivable	3,267,618	6,841,171
Inventory	150,810	145,264
Prepaid expenses	311,104	155,002
Investments	57,825,780	59,006,122
Charitable remainder trusts and gift annuities	21,340,556	18,007,745
Buildings and equipment, net	35,916,106	26,000,931
 Total Assets	 \$ 121,997,379	 \$ 115,774,240
 <u>LIABILITIES AND NET ASSETS</u>		
Liabilities		
Accounts payable and accrued expenses	\$ 2,819,489	\$ 1,900,760
Deferred income	510,800	652,786
Loans payable	2,289,777	1,065,606
Gift annuity liabilities	3,963	2,224
 Total Liabilities	 5,624,029	 3,621,376
 Net Assets		
Without donor restrictions	66,813,781	59,823,594
With donor restrictions	49,559,569	52,329,270
 Total Net Assets	 116,373,350	 112,152,864
 Total Liabilities and Net Assets	 \$ 121,997,379	 \$ 115,774,240

See accompanying notes

SANTA BARBARA MUSEUM OF ART
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2019
With Comparative Totals for the Year Ended June 30, 2018

	Without Donor Restrictions	With Donor Restrictions	Total All Funds	
			2019	2018
Income				
Support and Revenue:				
Admissions	\$ 80,623	\$ -	\$ 80,623	\$ 79,218
Events, programs, classes and lectures	186,280	-	186,280	178,392
Membership income	665,165	-	665,165	726,178
Contributions and grants	1,137,603	3,084,470	4,222,073	7,588,702
Special events, net of event expenses of \$67,239 and \$49,580	11,593	-	11,593	21,003
Membership tours, net of tour expenses of \$1,399,997 and \$1,032,118	248,463	-	248,463	109,151
Museum store sales, net of store expenses of \$415,609 and \$420,815	(46,929)	-	(46,929)	(49,541)
Change in value of charitable trusts and gift annuities	-	3,460,768	3,460,768	4,695,972
Distributions from perpetual trusts	413,705	-	413,705	462,290
Investment income, net	1,384,493	544,146	1,928,639	3,745,256
Exhibition and collection management income	112,149	-	112,149	98,210
Other income	11,363	-	11,363	36,844
Total income	4,204,508	7,089,384	11,293,892	17,691,675
Net assets released from restrictions	9,859,085	(9,859,085)	-	-
Expenses				
Program:				
Curatorial, collection management and exhibitions	2,083,308	-	2,083,308	2,346,484
Education, programs and outreach	1,293,088	-	1,293,088	1,252,364
Membership	253,158	-	253,158	154,999
Building services and security	1,547,214	-	1,547,214	1,981,702
Total Program Expenses	5,176,768	-	5,176,768	5,735,549
Supporting Services:				
Management and general	1,130,953	-	1,130,953	1,011,908
Fundraising and development	493,865	-	493,865	505,796
Total Supporting Services	1,624,818	-	1,624,818	1,517,704
Total Expenses	6,801,586	-	6,801,586	7,253,253
Excess (Deficit) of Revenue, Gains and Other Support Over Expenses Before Other Changes in Net Assets	7,262,007	(2,769,701)	4,492,306	10,438,422
Other Changes in Net Assets:				
Deaccessioning income	2,495	-	2,495	42,012
Acquisition of art	(274,315)	-	(274,315)	(336,850)
Total Other Changes in Net Assets	(271,820)	-	(271,820)	(294,838)
Change in net assets	6,990,187	(2,769,701)	4,220,486	10,143,584
Net assets, beginning of the year	59,823,594	52,329,270	112,152,864	102,009,280
Net assets, end of year	\$ 66,813,781	\$ 49,559,569	\$ 116,373,350	\$ 112,152,864

See accompanying notes

**SANTA BARBARA MUSEUM OF ART
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended June 30, 2019**

	Program					Supporting Services		
	Curatorial, collection, management and exhibitions	Education, programs and outreach	Building services and security	Tours, store and Membership	Total Program	Management	Fundraising	Total Expenses
Salaries and related costs	\$ 1,410,029	\$ 877,717	\$ 1,053,214	\$ 378,535	\$ 3,719,495	\$ 794,988	\$ 378,145	\$ 4,892,628
Services and professional fees	169,881	126,195	16,207	35,983	348,267	38,240	19,557	406,063
Equipment and supplies	26,774	69,884	30,058	12,845	139,560	35,679	17,637	192,876
Postage and shipping	101,996	6,069	1,874	18,489	128,428	17,780	10,781	156,988
Maintenance and installation	111,408	27,617	170,266	3,575	312,865	12,212	6,107	331,183
Printing, publications and advertising	81,600	80,204	-	56,957	218,761	2,756	24,838	246,355
Occupancy	74,022	77,359	173,728	23,855	348,964	97,731	9,327	456,022
Depreciation	104,147	68,048	100,157	103,305	375,657	56,341	24,293	456,291
Merchandise	-	-	-	187,822	187,822	-	-	187,822
Merchant, bank and other fees	3,452	27,235	1,710	1,247,399	1,279,795	75,226	3,181	1,358,202
Total expenses by function	2,083,308	1,360,327	1,547,214	2,068,764	7,059,613	1,130,953	493,865	8,684,431
Less expenses included with revenues on the statement of activities								
Tour expenses	-	-	-	(1,399,997)	(1,399,997)	-	-	(1,399,997)
Store expenses	-	-	-	(415,609)	(415,609)	-	-	(415,609)
Special events	-	(67,239)	-	-	(67,239)	-	-	(67,239)
Total included in expense section on the statement of activities	\$ 2,083,308	\$ 1,293,088	\$ 1,547,214	\$ 253,158	\$ 5,176,768	\$ 1,130,953	\$ 493,865	\$ 6,801,586

See accompanying notes

SANTA BARBARA MUSEUM OF ART
STATEMENT OF CASH FLOWS
For the Years Ended June 30, 2019 and 2018

	2019	2018
Cash Flows From Operating Activities		
Increase in net assets	\$ 4,220,486	\$ 10,143,584
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	456,291	457,572
Net realized and unrealized gain on investments	(161,830)	(2,327,295)
Non-cash change in value of charitable trusts and gift annuities	(3,460,768)	(4,695,972)
Changes in:		
Accounts receivable	14,623	(3,060)
Bequests and pledges receivable	3,573,553	1,071,074
Inventory	(5,546)	(25,731)
Prepaid expenses	(156,102)	402,189
Accounts payable and accrued expenses	918,729	1,099,172
Deferred revenue	(141,986)	259,587
Gift annuity liabilities	1,739	(46,597)
Net Cash Provided by Operating Activities	<u>5,259,189</u>	<u>6,334,523</u>
Cash Flows From Investing Activities		
Payments for equipment and building improvements	(10,371,466)	(7,133,311)
Proceeds from sale and maturities of investments	12,661,392	25,024,218
Purchases of investments	<u>(11,319,220)</u>	<u>(23,057,052)</u>
Net Cash Used by Financing Activities	<u>(9,029,294)</u>	<u>(5,166,145)</u>
Cash Flows From Financing Activities		
Payments on long-term debt	(25,829)	(24,665)
Proceeds from draw on line of credit	1,250,000	-
Payments from (to) gift annuitants	<u>127,957</u>	<u>780,698</u>
Net Cash Provided by Financing Activities	<u>1,352,128</u>	<u>756,033</u>
Increase (decrease) in cash and cash equivalents	(2,417,978)	1,924,411
Cash and cash equivalents, beginning of year	<u>5,602,298</u>	<u>3,677,887</u>
Cash and cash equivalents, end of year	<u>\$ 3,184,320</u>	<u>\$ 5,602,298</u>
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 46,624</u>	<u>\$ 47,787</u>

See accompanying notes

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

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 25,000 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 60,000 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 20,000 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

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.

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.

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.

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 fiscal year. The investments in 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 basis 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.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

Classification of Net Assets

The Museum reports information regarding its financial position and activities based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Museum are classified and reported as follows:

Net assets without donor restrictions – Net assets available for use in general operations without any donor-imposed restrictions. From time to time, the Museum’s Board of Trustees may designate certain net assets for particular purposes and objectives.

Net assets with donor restrictions – Net assets that are subject to donor-imposed restrictions that will be met either by actions of the Museum and/or the passage of time. These balances represent the unexpended portion of donor-restricted contributions and investment return to be used for specific programs and activities as directed by the donor. These balances also include net assets subject to donor-imposed restrictions that they must be maintained permanently (e.g. endowment funds). Typically, the donors of these types of assets allow the Museum to use the income earned on the related investments for general or specific purposes.

Contributions

Contributions are recorded as *without donor restriction* unless the donor stipulates a specific purpose. Donor-restricted contributions are recorded as an increase in net assets *with donor restrictions* depending on the nature of the restriction. When a restriction expires, net assets are reclassified to *without donor restriction*. Donated marketable securities are recorded at fair market value on the date of donation.

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.

Exhibitions

The Museum records all contributions for future exhibitions as revenue with donor restrictions 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.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

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.

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, 2019, 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 2014.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

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.
- 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.

Comparative Amounts

The amounts shown for the year ended June 30, 2018, in the accompanying financial statements are included to provide a basis for comparison with June 30, 2019, and are not intended to present all information necessary for a fair presentation of the June 30, 2018 financial statements in conformity with accounting principles generally accepted in the United States of America.

Recent Accounting Updates

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14), which is intended to simplify how a not-for-profit presents net assets and other information in the financial statements. This ASU specifically focuses on the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, lack of consistency in the type of information provided about expenses and investment return, and misunderstandings about and opportunities to enhance the utility of the statement of cash flows. The Museum adopted ASU 2016-14 for the year ended June 30, 2019 and has adjusted the presentation of these statements accordingly. The ASU has been applied retrospectively to all periods presented.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

In June 2018, the FASB issued Accounting Standards Update No. 2018-08, *Not-for-Profit Entities: Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* (ASU 2018-08). This ASU clarifies and improves guidance concerning 1) the determination whether a transaction should be accounted for as an exchange transaction or as a contribution, and 2) determining whether a contribution is conditional or unconditional. ASU 2018-08 is effective for the Museum for the year ended June 30, 2020 and should be applied on a modified prospective basis. Management is currently in the process of evaluating the impact of this guidance on its financial statements and related disclosures.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09) and has subsequently issued a number of amendments to ASU 2014-09. The new standard, as amended, supersedes nearly all existing revenue recognition guidance, including industry specific guidance and requires revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This ASU is effective for the Museum for the year ended June 30, 2020. Management is currently in the process of evaluating the impact of this guidance on its financial position, results of operations, and cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases* (ASU 2016-02). This ASU provides accounting guidance for both lessee and lessor accounting models. Among other things, lessees will recognize a right-of-use asset and a lease liability for leases with a duration of greater than one year. For income statement purposes, ASU 2016-02 will require leases to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. The new standard will be effective for the Museum for the year ended June 30, 2022. Management is currently in the process of evaluating the impact of this guidance on its financial position, results of operations, and cash flows.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 3 - Liquidity and Availability

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, consist of the following:

Total financial assets available to fund general operations at June 30, 2019	\$ 29,245,933
Plus other funds subject to appropriation for operations on donor restricted endowment funds	
Fiscal year 2020 estimated endowment appropriation for operations	1,200,000
Fiscal year 2020 estimated trust distributions	<u>350,000</u>
Total financial assets available within one year	<u>\$ 30,795,933</u>

The Museum has endowment funds that consist of both donor-restricted and board-designated amounts. The Board-designated funds available for general use are included above as are the estimated earnings on donor-restricted funds providing they are also available for general use.

As part of the Museum's liquidity management procedures, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, the Museum invests cash in excess of daily requirements in short term investments and money market funds. Occasionally, the Board designates a portion of any operating surplus to its operating reserve.

Note 4 - 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, 2019, the Museum has total bequests and pledges receivable of \$3,267,618. Management expects no material write-offs for receivables at June 30, 2019; therefore, no current provision has been made. These pledges and bequests are expected to be collected as follows:

Less than one year	\$ 1,902,308
More than one year	<u>1,365,310</u>
Total bequests and pledges receivable	<u>\$ 3,267,618</u>

See also Note 20.

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

Note 5 - Investments

Investments consist of the following at June 30, 2019:

	<u>Cost</u>	<u>Market</u>
Marketable Securities:		
Cash equivalents	\$ 1,521,416	\$ 1,521,416
Common stocks	6,101,995	7,104,369
Stock mutual funds	27,303,567	30,367,974
Bond mutual funds	<u>10,611,520</u>	<u>10,604,879</u>
Total Marketable Securities	45,538,498	49,598,638
Alternative Investments	<u>8,227,142</u>	<u>8,227,142</u>
Total Investments	<u>\$ 53,765,640</u>	<u>\$ 57,825,780</u>
Unrealized gain as of June 30, 2019		\$ 4,060,140
Unrealized gain as of June 30, 2018		<u>5,748,141</u>
Changes in unrealized gains		<u>\$ (1,688,001)</u>

The market values of marketable securities are from quoted prices as of June 30, 2019, 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, 2019, the Museum had remaining investment commitments to alternative investment partnerships that are not readily marketable in an amount not to exceed \$1,831,000. Investment income is allocated to participating funds based upon each fund's respective percentage share 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 twenty-quarter 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, 2019 consists of:

Interest and dividends	\$ 1,124,633
Net realized gains	1,849,830
Partnership income	831,826
Net change in unrealized loss	(1,688,001)
Less investment expenses	<u>(189,649)</u>
Net investment income	<u>\$ 1,928,639</u>

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 6 - 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.
- 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.

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

Note 6 - Fair Value Measurement (continued)

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.

The following table sets forth by level within the fair value hierarchy the assets at fair values as of June 30, 2019:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Money market	\$ 1,521,416	\$ -	\$ -	\$ 1,521,416
Common stocks	7,104,369	-	-	7,104,369
Stock mutual funds	30,367,974	-	-	30,367,974
Bond mutual funds	10,604,879	-	-	10,604,879
Partnerships	-	-	8,227,142	8,227,142
Total Investments	49,598,638	-	8,227,142	57,825,780
Charitable trust agreements	-	21,340,556	-	21,340,556
Total assets measured at fair value	<u>\$ 49,598,638</u>	<u>\$ 21,340,556</u>	<u>\$ 8,227,142</u>	<u>\$ 79,166,336</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, 2019:

Balance, beginning of year	\$ 9,039,849
Partnership gain	831,826
Purchases and issuances	200,014
Sales and settlements	<u>(1,844,547)</u>
Balance, end of year	<u>\$ 8,227,142</u>

Note 7 - 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

Note 7 - 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 8 - 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 and classified as net assets with donor restrictions. 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.

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 2.8%, based on the IRS discount rate as of June 30, 2019.

Note 9 - 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.

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.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 9 - Perpetual Income Trust Interests (continued)

Upon receipt of trust distributions or expenditures, or both, in satisfaction of the donor-restricted purpose, if any, net assets with donor-imposed time or purpose restrictions are released to net assets without donor restrictions.

Note 10 - Buildings and Equipment

At June 30, 2019, the cost of buildings and equipment, net of accumulated depreciation was as follows:

Buildings and improvements	\$ 19,882,100
Construction in progress	31,065,811
Furniture and equipment	<u>4,214,806</u>
Total cost	55,162,717
Less accumulated depreciation	<u>(19,246,611)</u>
Buildings and equipment, net	<u><u>\$ 35,916,106</u></u>

Depreciation expense for the year ended June 30, 2019 was \$456,291.

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 \$1,039,777.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 11 - Loans Payable

The Museum has a note payable of \$1,039,777 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:

2020	\$	26,732
2021		28,068
2022		29,338
2023		30,666
2024		31,944
Thereafter		<u>893,029</u>
Total	\$	<u><u>1,039,777</u></u>

The Museum paid \$46,624 in interest for the year ended June 30, 2019.

Additionally, the Museum entered into a \$12,000,000 non-revolving line of credit. As of June 30, 2019, the Museum has an outstanding balance of \$1,250,000. See Note 21.

Note 12 - 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, 2019.

Note 13 - 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, 2019 was \$112,030.

Note 14 - Unemployment Benefits

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

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 15 - 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, 2019, the Museum had approximately \$3,260,000 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 16 - Operating Leases

The Museum leases various office equipment under non-cancellable operating leases through June 2023. Minimum rental payments under the terms of these leases are as follows for the year ending June 30:

2020	\$	40,909
2021		11,529
2022		5,653
2023		5,653
2024		-
Total	\$	<u>63,744</u>

Lease expense for the year ended June 30, 2019 totaled \$56,630.

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

Note 17 - Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of the passage of time or other event specified by donors or by appropriation by the Board of Trustees for expenditure. For the year ended June 30, 2019, the passage of time or expenditures fulfilling restricted purposes is as follows:

Purpose restrictions:

General operations	\$ 356,924
Education programs	278,000
Exhibitions	222,495
Art acquisition	83,926
Renovation project	<u>8,573,651</u>
Total purpose restrictions	<u>9,514,996</u>

Passage of time:

Salaries and related expenses	285,704
Education	<u>58,385</u>
Total passage of time	<u>344,089</u>
Total released from restrictions	<u><u>\$ 9,859,085</u></u>

Note 18 - Net Assets

Net assets without donor restrictions consist of funds without any donor-imposed time or purpose stipulations and are classified as either undesignated funds or Board-designated funds. Net assets without donor restrictions as of June 30, 2019, are as follows:

General unrestricted	\$ 35,792,427
Board-designated funds	
Conservation	1,791,421
Education	662,904
Art acquisition	1,111,482
General operations	<u>27,455,547</u>
Total Board-designated funds	<u>31,021,354</u>
Total net assets without donor restriction	<u><u>\$ 66,813,781</u></u>

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

Note 18 - Net Assets (continued)

Net assets with donor restrictions are restricted for the following purposes or periods at June 30, 2019:

Subject to expenditure for specific purpose:

Exhibitions	\$ 227,746
Art Acquisitions	1,086,841
Promises to give, the proceeds from which have been restricted by donors for Exhibitions	100,000
	<u>1,414,587</u>

Subject to passage of time:

Assets held under split-interest agreements	<u>7,094,295</u>
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Endowments:

Subject to appropriation and expenditure when
a specified event occurs:

Restricted by donors for

General operations	1,081,925
Art Acquisition	1,262,248
Conservation	1,285,386
Exhibitions	186,954
Education	113,241
	<u>3,929,754</u>

Subject to endowment spending policy
and appropriation:

General operations	19,298,295
Art Acquisition	1,001,065
Conservation	1,621,035
Exhibitions	316,000
Education	638,276
	<u>22,874,671</u>

Total Endowments

26,804,426

Not subject to spending policy or appropriation:

Beneficial interests in perpetual trusts and split interest agreements	14,246,261
Total net assets with donor restrictions	<u>\$ 49,559,569</u>

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 19 - Endowment Funds

The Museum's endowment consists of 65 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.

In accordance with California UPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate earnings on donor designated endowment funds:

- (1) The duration and preservation of the fund.
- (2) The purposes of the Museum and the donor-designated 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.

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

Note 19 - Endowment Funds (continued)

Endowment net assets are composed of the following as of June 30, 2019:

	<u>With donor restrictions</u>	<u>Without donor restrictions</u>	<u>Total endowment</u>
Board designated endowment	\$ -	\$ 28,902,540	\$ 28,902,540
Accumulated earnings on donor restricted endowments	-	2,118,814	2,118,814
Original donor-restricted gift amounts	22,874,672		22,874,672
Accumulated earnings on donor restricted endowments	<u>3,929,754</u>	<u>-</u>	<u>3,929,754</u>
Total	<u>\$ 26,804,426</u>	<u>\$ 31,021,354</u>	<u>\$ 57,825,780</u>

Changes in endowment net assets for the year ended June 30, 2019 are:

	<u>With donor restrictions</u>	<u>Without donor restrictions</u>	<u>Total endowment</u>
Endowment net assets, beginning of year, as reclassified	\$ 26,569,369	\$ 32,116,072	\$ 58,685,441
Net investment return	544,146	1,345,889	1,890,035
Contributions	35,000	34,000	69,000
Appropriations	<u>(344,089)</u>	<u>(2,474,607)</u>	<u>(2,818,696)</u>
Endowment net assets, end of year	<u>\$ 26,804,426</u>	<u>\$ 31,021,354</u>	<u>\$ 57,825,780</u>

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 19 - 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.

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 twenty-quarter moving average fair value of the permanent 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 maintain the purchasing power of its assets held in perpetuity as well as to provide additional real growth through new gifts and investment return. If additional funds beyond the 4.95% policy are needed by the Museum for operations or other specific Board approved purposes, then the additional amounts are drawn from Board-designated endowment funds.

Endowment Funds with Deficiencies

From time to time, the fair value of the assets associated with individual donor-designated 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 result from unfavorable market fluctuations. As of June 30, 2019, no such deficiency existed.

SANTA BARBARA MUSEUM OF ART
NOTES TO FINANCIAL STATEMENTS

Note 20 - Capital Campaign

In 2012, the Museum entered into a capital campaign to fund the cost of the renovation of its facilities. Many of the account balances presented in the financial statements reflect an increased level of activity resulting from the capital campaign and the renovation, including cash and cash equivalents, bequests and pledges receivable, charitable remainder trusts and gift annuities, buildings and equipment, accounts payable and accrued expenses, and contributions and grants.

Note 21 - Commitments

The Museum has entered into a construction contract with Diani Building Corporation for the Museum renovation project in the amount of \$29,140,000. Through June 30, 2019, the Museum has incurred approximately \$18,000,000 under the construction contract.

The Museum has entered into a \$12,000,000 non-revolving line of credit agreement with Bank of America. 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 1.25%. The line of credit is secured by publicly traded securities in the Museum's investment account held at Bank of America. On September 30, 2020, all outstanding principal and interest will automatically convert to a term loan with a fixed interest rate of 3.125%. Payment will be based on a 20 year amortization with outstanding principal and interest due on August 31, 2027. As of June 30, 2019, \$1,250,000 has been drawn on the line of credit.

Note 22 - Subsequent Events

Management has evaluated subsequent events through November 21, 2019, 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.