

**SANTA BARBARA MUSEUM OF ART  
FINANCIAL STATEMENTS**

**JUNE 30, 2010**

**SANTA BARBARA MUSEUM OF ART**

June 30, 2010

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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## INDEPENDENT AUDITOR'S REPORT

Board of Trustees  
Santa Barbara Museum of Art  
Santa Barbara, California

We have audited the accompanying statement of financial position of the Santa Barbara Museum of Art (a non-profit organization) as of June 30, 2010, and the related statements of activities and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit. Information for the year ended June 30, 2009, is presented for comparative purposes only and was extracted from the financial statements for that year, on which an unqualified opinion dated October 13, 2009, was expressed.

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 misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2010, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Notes 1, 3, and 4 to the financial statements, the statement of financial position includes investments valued at \$17,923,667 (26% of net assets) as of June 30, 2010, whose fair market values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based upon information provided by the investment managers.

*McGowan Guntermann*

October 26, 2010

**SANTA BARBARA MUSEUM OF ART**

**STATEMENT OF FINANCIAL POSITION**

June 30, 2010

(With Comparative Totals as of June 30, 2009)

**ASSETS**

	Unrestricted	Temporarily Restricted	Permanently Restricted	2010 Total	(Memo) 2009 Total
<b>ASSETS</b>					
Cash and cash equivalents	\$ 659,907	\$ 733,847	\$ -	\$ 1,393,754	\$ 1,332,462
Accounts receivable	40,097	-	-	40,097	16,868
Bequests and pledges receivable	-	913,268	-	913,268	684,200
Inventory	235,524	-	-	235,524	286,043
Prepaid expenses	186,637	-	-	186,637	280,343
Investments	31,132,657	664,860	17,790,272	49,587,789	46,769,467
Gift annuity assets	-	103,992	-	103,992	96,975
Charitable trust agreements	-	3,163,778	6,457,701	9,621,479	9,473,748
Buildings and equipment, net	8,981,725	-	-	8,981,725	9,635,194
Collections	-	-	-	-	-
<b>TOTAL ASSETS</b>	<b><u>\$ 41,236,547</u></b>	<b><u>\$ 5,579,745</u></b>	<b><u>\$ 24,247,973</u></b>	<b><u>\$ 71,064,265</u></b>	<b><u>\$ 68,575,300</u></b>

**LIABILITIES AND NET ASSETS**

	Unrestricted	Temporarily Restricted	Permanently Restricted	2010 Total	(Memo) 2009 Total
<b>LIABILITIES</b>					
Accounts payable and accrued expenses	\$ 438,483	\$ -	\$ -	\$ 438,483	\$ 419,950
Deferred revenue	89,213	-	-	89,213	260,474
Note payable	1,848,794	-	-	1,848,794	1,873,271
Future annuities payable under charitable trust and gift annuity agreements	-	160,836	-	160,836	175,606
<b>Total Liabilities</b>	<b><u>2,376,490</u></b>	<b><u>160,836</u></b>	<b><u>-</u></b>	<b><u>2,537,326</u></b>	<b><u>2,729,301</u></b>
<b>NET ASSETS</b>					
Unrestricted					
Board designated	34,317,403	-	-	34,317,403	32,029,080
Underwater endowments	(1,972,650)	-	-	(1,972,650)	(2,854,366)
Other unrestricted	6,515,304	-	-	6,515,304	6,767,200
<b>Total Unrestricted</b>	<b><u>38,860,057</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>38,860,057</u></b>	<b><u>35,941,914</u></b>
Temporarily restricted	-	5,418,909	-	5,418,909	5,840,732
Permanently restricted	-	-	24,247,973	24,247,973	24,063,353
<b>Total Net Assets</b>	<b><u>38,860,057</u></b>	<b><u>5,418,909</u></b>	<b><u>24,247,973</u></b>	<b><u>68,526,939</u></b>	<b><u>65,845,999</u></b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 41,236,547</u></b>	<b><u>\$ 5,579,745</u></b>	<b><u>\$ 24,247,973</u></b>	<b><u>\$ 71,064,265</u></b>	<b><u>\$ 68,575,300</u></b>

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

**SANTA BARBARA MUSEUM OF ART**

**STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**

For the Year Ended June 30, 2010

(With Comparative Totals for the Year Ended June 30, 2009)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2010 Total	(Memo) 2009 Total
<b>REVENUE, GAINS AND OTHER SUPPORT</b>					
Admissions	\$ 222,502	\$ -	\$ -	\$ 222,502	\$ 138,152
Programs, classes and lectures	214,508	-	-	214,508	359,163
Membership income	572,179	-	-	572,179	519,748
Contributions and grants	647,841	914,599	50,000	1,612,440	2,171,445
Bequests	-	500,000	-	500,000	70,000
Special events (net of event expense of \$57,885 and \$78,618)	45,807	-	-	45,807	47,010
Membership tours (net of tour expense of \$731,234 and \$632,484)	(25,368)	-	-	(25,368)	(44,265)
Museum store sales (net of store expenses of \$572,675 and \$644,308)	42,622	-	-	42,622	1,587
Change in value of charitable trusts & gift annuities	-	231,311	134,620	365,931	(2,067,548)
Distributions from perpetual trusts	145,714	86,259	-	231,973	524,995
Investment income (loss), net	4,936,287	1,208,099	-	6,144,386	(13,362,744)
Exhibition and collection management income	31,167	-	-	31,167	46,354
Other income	58,183	-	-	58,183	48,824
Net assets released from restrictions	3,529,971	(3,529,971)	-	-	-
 Net Revenue, Gains and Other Support	 <u>10,421,413</u>	 <u>(589,703)</u>	 <u>184,620</u>	 <u>10,016,330</u>	 <u>(11,547,279)</u>
<b>EXPENSES</b>					
Program					
Curatorial, collection management, and exhibitions	1,559,931	-	-	1,559,931	1,216,611
Education, programs, and outreach	1,336,823	-	-	1,336,823	1,516,232
Membership	177,925	-	-	177,925	206,391
Building services and security	2,185,702	-	-	2,185,702	2,033,788
Total Program Expenses	<u>5,260,381</u>	<u>-</u>	<u>-</u>	<u>5,260,381</u>	<u>4,973,022</u>
Supporting Services					
Management and general	1,160,762	-	-	1,160,762	1,208,816
Fundraising and development	544,024	-	-	544,024	424,699
Total Supporting Services	<u>1,704,786</u>	<u>-</u>	<u>-</u>	<u>1,704,786</u>	<u>1,633,515</u>
 Total Expenses	 <u>6,965,167</u>	 <u>-</u>	 <u>-</u>	 <u>6,965,167</u>	 <u>6,606,537</u>
 Excess of Revenue, Gains, and Other Support over Expenses before Other Changes in Net Assets	 3,456,246	 (589,703)	 184,620	 3,051,163	 (18,153,816)
Other Changes in Net Assets					
Deaccessioning income	-	167,880	-	167,880	8,640
Acquisition of Art	(538,103)	-	-	(538,103)	(857,182)
Total Other Changes in Net Assets	<u>(538,103)</u>	<u>167,880</u>	<u>-</u>	<u>(370,223)</u>	<u>(848,542)</u>
 <b>CHANGES IN NET ASSETS</b>	 <b><u>2,918,143</u></b>	 <b><u>(421,823)</u></b>	 <b><u>184,620</u></b>	 <b><u>2,680,940</u></b>	 <b><u>(19,002,358)</u></b>
 NET ASSETS, BEGINNING OF YEAR	 33,487,382	 7,954,264	 24,404,353	 65,845,999	 84,848,357
 RECLASSIFICATION OF NET ASSETS	 <u>2,454,532</u>	 <u>(2,113,532)</u>	 <u>(341,000)</u>	 <u>-</u>	 <u>-</u>
 NET ASSETS, AS RECLASSIFIED	 35,941,914	 5,840,732	 24,063,353	 65,845,999	 84,848,357
 <b>NET ASSETS, END OF YEAR</b>	 <b><u>\$ 38,860,057</u></b>	 <b><u>\$ 5,418,909</u></b>	 <b><u>\$ 24,247,973</u></b>	 <b><u>\$ 68,526,939</u></b>	 <b><u>\$ 65,845,999</u></b>

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

**SANTA BARBARA MUSEUM OF ART**

**STATEMENT OF CASH FLOWS**

For the Year Ended June 30, 2010

(With Comparative Totals for the Year Ended June 30, 2009)

	2010	(Memo) 2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Changes in net assets	\$ 2,680,940	\$ (19,002,358)
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	735,331	686,912
Investment (gain) loss	(5,635,812)	13,972,152
Non-cash donations of stock	(7,675)	(232,619)
Non-cash change in value of charitable trusts and gift annuities	15,394	2,077,300
Contributions restricted for long-term investment	(50,000)	(136,200)
Changes in:		
Accounts receivable	(23,229)	14,305
Bequests and pledges receivable	(229,068)	(245,707)
Inventory	50,519	(16,967)
Prepaid expenses	93,706	9,993
Accounts payable and accrued expenses	18,533	(107,192)
Deferred revenue	(171,264)	(113,998)
Gift annuity liabilities	<u>(14,770)</u>	<u>(21,992)</u>
<b>NET CASH USED BY OPERATING ACTIVITIES</b>	<u>(2,537,395)</u>	<u>(3,116,371)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Contributions restricted for long-term investment	50,000	136,200
Payments on long-term debt	(24,477)	(23,026)
Payments to gift annuitants	<u>(170,142)</u>	<u>(24,481)</u>
<b>NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES</b>	<u>(144,619)</u>	<u>88,693</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Payments for equipment and building improvements	(81,862)	(1,520,010)
Proceeds from sale and maturities of investments	8,484,990	8,542,564
Purchases of investments	<u>(5,659,822)</u>	<u>(4,189,372)</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u>2,743,306</u>	<u>2,833,182</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>61,292</b>	<b>(194,496)</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b>	<u>1,332,462</u>	<u>1,526,958</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<b><u>\$ 1,393,754</u></b>	<b><u>\$ 1,332,462</u></b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the year for interest	\$ 114,058	\$ 115,509

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

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### 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 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.

Each year the Museum hosts ten or more special exhibitions, some traveling from other museums. In the past five years, the Museum has also originated eight major exhibitions, with accompanying scholarly publications that have traveled nationally and internationally. Annual attendance at the Museum averages over 130,000 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 forty 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 life long 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 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Fund Accounting

The accounts of the Museum are maintained in accordance with the principles of fund accounting. This accounting and reporting method classifies resources by their nature and purpose into three classes of net assets based on the presence 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 groups funds include resources of certain groups (Women's Board, Docents, Museum's Collector Council, and Friends of Contemporary Art, 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 and removed by actions of the Museum that fulfill donor stipulations, or funds 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, capital funds or endowment funds. Art acquisition funds are available only for the acquisition of art. Capital funds include fixed assets whose use is fixed into perpetuity. Endowment funds are invested to provide income to support either specific activities or general operations, in accordance with donor stipulations.

#### Revenue

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

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Tax Status

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, 2010, the Museum had no uncertain tax positions requiring 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 before 2006.

#### 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 downward for losses 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.

#### 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.

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Building and Equipment

Building 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 exhibits as deferred revenue and all expenditures for future exhibits as prepaid expenses. The revenue and expenses are recognized in the year the exhibit 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 Generally Accepted Accounting Principles, 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 or permanently restricted net assets. Donated marketable securities are recorded at fair market value on the date of donation.

#### 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.

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 - 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.
- Allowance for uncollectible and discount factors used in determining present values of contributions receivable.
- Allocation of expenses to various program and support service categories.

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, 2009 in the accompanying financial statements are included to provide a basis for comparison with June 30, 2010 and are not intended to present all information necessary for a fair presentation of the June 30, 2009 financial statements in conformity with accounting principles generally accepted in the United States of America.

### NOTE 2 - BEQUESTS AND PLEDGES RECEIVABLE

As of June 30, 2010, the Museum has total pledges and bequests receivable of \$913,268 which management expects to collect in full. These pledges and bequests are expected to be collected as follows:

Less than one year	\$ 678,268
One to five years	<u>235,000</u>
Total pledges receivable	<u>\$ 913,268</u>

**SANTA BARBARA MUSEUM OF ART**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 3 - INVESTMENTS**

Investments consist of the following at June 30, 2010:

	<u>Cost</u>	<u>Market</u>
Marketable Securities:		
Cash equivalents	\$ 845,267	\$ 845,267
Common stocks	5,483,663	4,176,130
Fixed income securities	761,348	958,354
Stock mutual funds	2,023,893	3,817,118
Bond mutual funds	4,343,368	4,749,645
International mutual funds	<u>18,494,683</u>	<u>17,117,608</u>
 Total Marketable Securities	 31,952,222	 31,664,122
 Alternative Investments	 <u>17,923,667</u>	 <u>17,923,667</u>
 Total Investments	 <u>\$ 49,875,889</u>	 <u>\$ 49,587,789</u>
 Unrealized loss as of June 30, 2010		 \$ (288,100)
 Unrealized loss as of June 30, 2009		 <u>(3,070,486)</u>
 Change in unrealized gain		 <u>\$ 2,782,385</u>

None of these financial instruments are held for trading purposes. These amounts are not necessarily indicative of the amounts the Museum could realize in a current market exchange. The market values of marketable securities are from quoted prices as of June 30, 2010, and the market value of alternative investment partnerships are provided by the general partners. At June 30, 2010, the Museum had remaining investment commitments to alternative investment partnerships that are not readily marketable in an amount not to exceed \$787,500.

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 quasi-endowment investment funds as of December 31.

The net investment gain for the year ended June 30, 2010 consists of:

Interest and dividends	\$ 662,635
Net realized gain	173,504
Partnership gain	2,679,923
Net change in unrealized gain	2,782,385
Less investment expenses	<u>(154,061)</u>
Net investment gain	<u>\$ 6,144,386</u>

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 4 - FAIR VALUE MEASUREMENT

Generally accepted accounting principles have established a framework for measuring fair value and expanding disclosures about fair value measurements. Accounting principles define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes valuation inputs into three broad levels to ensure consistency and comparability. The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

Accounting principles describe three levels of inputs that may be used to measure fair value 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; including general partner estimates and recent third-party appraisals.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying Statement of Financial Position, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, securities are classified with Level 1 of the valuation hierarchy. Level 1 securities include highly-liquid government bonds and exchange traded equities. If quoted market prices are not available, then Level 2 fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 3 securities include hedge funds, private equity, real assets, and partnerships.

**SANTA BARBARA MUSEUM OF ART**

NOTES TO FINANCIAL STATEMENTS

NOTE 4 - FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents the fair value measurements of assets recognized in the accompanying Statement of Financial Position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2010:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Cash equivalents	\$ 845,267	\$ -	\$ -	\$ 845,267
Common stocks	4,176,130	-	-	4,176,130
Fixed income	958,354	-	-	958,354
Stock mutual funds	3,817,118	-	-	3,817,118
Bond mutual funds	4,749,645	-	-	4,749,645
International mutual funds	17,117,608	-	-	17,117,608
Partnerships	<u>-</u>	<u>-</u>	<u>17,923,667</u>	<u>17,923,667</u>
Total Investments	31,664,122	-	17,923,667	49,587,789
Receivables	-	953,365	-	953,365
Inventory	-	235,525	-	235,525
Gift annuity assets	-	103,992	-	103,992
Charitable trust agreements	<u>-</u>	<u>9,621,479</u>	<u>-</u>	<u>9,621,479</u>
Total assets measured at fair value	<u>\$ 31,664,122</u>	<u>\$ 10,914,361</u>	<u>\$ 17,923,667</u>	<u>\$ 60,502,150</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, 2010:

<u>Description</u>	<u>Beginning Balance</u>	<u>Net Purchases, Sales, and Transfers</u>	<u>Net Gains</u>	<u>Ending Balance</u>
Partnerships	<u>\$ 20,458,997</u>	<u>\$ (5,215,225)</u>	<u>\$ 2,679,895</u>	<u>\$ 17,923,667</u>

NOTE 5 - 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.

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 mortgage-backed securities.

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 6 - CHARITABLE TRUST AGREEMENTS

Irrevocable charitable trust agreements in which the Museum has been named as a 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 estimates 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 7 - 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 three discretionary trusts, the Museum is a beneficiary of this stream of income in perpetuity. The Museum's 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.

For the trust that provides reimbursement for Asian art expenditures, the Museum records the fair market value of the underlying assets held by the trustee. Any change in subsequent years in the fair market value of the Museum's share of the trust investments 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 8 - NOTE PAYABLE

The Museum has a note payable of \$1,848,794 secured by residential real estate at an interest rate of 6.125%. Payments of \$11,545 are due monthly with the final payment being due on April 1, 2038.

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

2011	\$ 26,019
2011	27,658
2012	29,401
2013	31,252
2014	35,314
Thereafter	<u>1,699,150</u>
Total	<u>\$1,848,794</u>

The Museum paid \$114,058 in interest for the year ended June 30, 2010.

### NOTE 9 - BUILDINGS AND EQUIPMENT

At June 30, 2010, the cost of buildings, equipment and improvements, net of accumulated depreciation, were as follows:

Buildings and improvements	\$ 19,679,923
Furniture and equipment	<u>3,303,024</u>
Total cost	22,982,947
Less accumulated depreciation	<u>(14,001,222)</u>
Buildings and equipment, net	<u>\$ 8,981,725</u>
Depreciation expense	<u>\$ 735,331</u>

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. A portion of the Museum, commonly known as the original museum building and the Park Wing, is now leased by the Museum from the County at no cost until March 2081. A more recent addition to the Museum, commonly known as the Peck Wing, is located on property owned by the Museum. Two separate buildings have been constructed on the separately-owned land. 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, equipment and improvements include one residence which is pledged as collateral on a note payable of \$1,848,794.

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 10 - DEFERRED REVENUE

Deferred revenue consists of money received in advance for member tours and for classes that will take place after June 30, 2010.

### NOTE 11 - BENEFIT PLANS

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 saving 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, 2010, was \$122,192.

### NOTE 12 - UNEMPLOYMENT BENEFITS

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

The Museum paid claims totaling \$6,690 during the year ended June 30, 2010.

### NOTE 13 - CONCENTRATION OF RISK

#### 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.

#### Credit Risk

The Museum maintains cash balances at several banks insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At times, balances may exceed federally insured limits. At June 30, 2010, the Museum had an excess of \$1,143,754 over the FDIC insured amount.

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 14 – OPERATING LEASES

The Museum leases various office equipment under non-cancellable operating leases through December, 2013. Minimum rental payments under the terms of these leases are as follows for the year ending June 30:

Minimum rental payments are as follows for the years ending June 30,

2011	\$ 19,321
2012	18,208
2013	11,161
2014	<u>2,407</u>
Total	<u>\$ 51,097</u>

Lease expense for the year ended June 30, 2010 totaled \$22,038.

### NOTE 15 - 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, 2010, the passage of time restrictions resulted in net assets released from restriction of \$3,529,971.

### NOTE 16 - NET ASSETS

Unrestricted net assets consist of funds without any donor-imposed restrictions and are classified as either undesignated funds or Board designated funds. As of June 30, 2010, unrestricted net assets are as follows:

General unrestricted	\$ 6,515,304
Donor-restricted endowment deficit	(1,972,650)
Board designated funds	
Conservation	1,637,835
Education	813,722
Art acquisition	1,122,279
General operations	<u>30,743,567</u>
Total Board designated funds	<u>34,317,403</u>
Total unrestricted net assets	<u>\$ 38,860,057</u>

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 16 - NET ASSETS (CONTINUED)

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. Donor restrictions of temporarily restricted net assets at June 30, 2010, are as follows:

Pledges receivable	\$ 913,268
Split-interest agreements	3,106,934
Donations with time restrictions	733,847
Un-appropriated earnings on endowments	<u>664,860</u>
Total temporarily restricted net assets	<u>\$ 5,418,909</u>

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 with specific activities or general operations, in accordance with donor stipulations. Donor restrictions of permanently restricted net assets at June 30, 2010 are as follows:

Perpetual interest trusts	\$ 6,457,701
Donor-restricted endowment funds	<u>17,790,272</u>
Total permanently restricted net assets	<u>\$ 24,247,973</u>

### NOTE 17 - ENDOWMENT FUNDS

The Museum's endowment consists of approximately 58 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 of the Museum 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 original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Museum in a manner consistent with the standard for prudence prescribed by UPMIFA.

**SANTA BARBARA MUSEUM OF ART**

NOTES TO FINANCIAL STATEMENTS

NOTE 17 - ENDOWMENT FUNDS (CONTINUED)

In accordance with California UPMIFA, the organization 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, 2010:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted	\$ ( 1,972,650)	\$ 664,860	\$ 17,790,272	\$ 16,482,452
Board-restricted	<u>33,867,403</u>	<u>-</u>	<u>-</u>	<u>33,867,403</u>
Total endowment funds	<u>\$ 31,894,753</u>	<u>\$ 664,860</u>	<u>\$ 17,790,272</u>	<u>\$ 50,349,885</u>

Changes in endowment net assets for the year ended June 30, 2010 are:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year, as reclassified	\$ 29,174,714	\$ 442,435	\$ 17,740,272	\$ 47,357,421
Net investment return (investment income, realized and unrealized gains and losses)	4,721,267	1,208,099	-	5,929,366
Contributions	49,000	-	50,000	50,000
Appropriation of endowment assets for expenditure	<u>(2,080,228)</u>	<u>(985,674)</u>	<u>-</u>	<u>(3,035,902)</u>
Endowment net assets, end of year	<u>\$ 31,894,753</u>	<u>\$ 664,860</u>	<u>\$ 17,790,272</u>	<u>\$ 50,349,885</u>

# SANTA BARBARA MUSEUM OF ART

## NOTES TO FINANCIAL STATEMENTS

### NOTE 17 - 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 organization 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, 2010, endowment fund deficiencies totaled \$1,972,650.

**SANTA BARBARA MUSEUM OF ART**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 18 – RECLASSIFICATION OF NET ASSETS**

Net assets have been reclassified as of July 1, 2009 for changes to endowment net asset classification based upon additional information obtained and interpretation of relevant law. As a result of the reclassification, permanently restricted net assets have been reduced by \$341,000, temporarily restricted net assets have been reduced by \$2,113,532 and unrestricted net assets have increased by \$2,454,532.

**NOTE 19 - SUBSEQUENT EVENTS**

The Museum has evaluated subsequent events through October 26, 2010, the date which the financial statements were available to be issued.