



SANTA BARBARA
HISTORICAL MUSEUM

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
FOR THE FISCAL YEAR ENDED

JUNE 30, 2018

SANTA BARBARA HISTORICAL MUSEUM

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
Santa Barbara Historical Museum

I have audited the accompanying financial statements of Santa Barbara Historical Museum (a non-profit organization)(the Organization) which comprise the statement of financial position as of June 30, 2018, the related statements of activities and of 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 (U.S. GAAP); 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

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Those standards require that I 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, I 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.

I believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Santa Barbara Historical Museum as of June 30, 2018, 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.

Other Matter

My audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses on pages 25 - 26 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Report on Summarized Comparative Information

I have previously audited the combined financial statements of the Santa Barbara Historical Museum as of June 30, 2017, and expressed an unmodified audit opinion on those audited financial in my report dated October 3, 2018. In my 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.

Santa Barbara, California
October 19, 2018

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 1: ORGANIZATIONAL INFORMATION

Founded in 1932 and incorporated in 1943, the Santa Barbara Historical Museum (dba The Santa Barbara Museum) (the Museum) is a California non-profit organization dedicated to promoting an appreciation and understanding of Santa Barbara regional history and the importance of history in general. Contributions and grants from residents and foundations located in Santa Barbara County are a key source of income to the Museum.

The Santa Barbara Historical Museum has a long legacy in our community, and an enduring commitment to its mission. The Museum remains dedicated to collecting, preserving, interpreting, and exhibiting the material culture of the Santa Barbara region in all its diversity; to educating through lectures, tours, and in the classroom; and to encouraging research, scholarship, and publication of the history of the Santa Barbara community. History can guide and inspire our actions, a tool with which we can build a better tomorrow. It is that belief which inspires the Museum's motto, "building a future worth remembering."

In addition to the Museum's signature exhibition, *The Story of Santa Barbara*, the Museum hosted four major exhibitions: *Missions in Watercolor by Edwin Deakin*, *Project Fiesta: The History of Old Spanish Days*, *Sacred Art in the Age of Contact: Chumash and Latin American Traditions*, *In the Saddle: Santa Barbara, Horses and the Way of the West*.

The Museum began transitional exhibitions in the Edward Borein Gallery, devoted to the art and life of one of the most highly regarded artists of the American West.

After years of restoration the Museum re-opened the Charles Fernald Mansion (1862) for public tours. The Victorian Queen Anne -style home, a Santa Barbara City Historical Landmark, was owned by Judge Charles Fernald, one of Santa Barbara's most prominent citizens in the late 1800s

Public programming included nearly thirty educational events - history lectures, panel discussions, art demonstrations, film screenings, exhibition premieres, walking tours, plus continuing education sessions for the Museum's core volunteers program. Public interest topics included life in early California, conservation, architecture, art, film, agriculture and other local history topics.

The Museum provided free after-hours receptions and family friendly activities for the public during eight "First Thursdays," a collaborative art and business promotion with Downtown Santa Barbara, along with playing host to numerous like-minded non-profit organizations, as well as educational groups. Additionally, the Museum hosted one fundraisers with an education/exhibition focus.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 1: ORGANIZATIONAL INFORMATION (Continued)

Along with many local history articles published in the *Santa Barbara Independent*, the Research Department produced two issues of *Noticias*, the Museum's scholarly journal.

Over 28,000 guests, including many school tours, visited the Museum to explore, attend public functions and utilize the research library in 2017-2018. Additionally, many others explored the Museum's satellite exhibits at the Historic Terminal of the Santa Barbara Airport and the transitional exhibition dedicated to architect Lulah Maria Riggs through the Healing Arts Program at Santa Barbara Cottage Hospital.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Classification of Funds:

The assets, liabilities and net assets of the Museum are reported in seven self-balancing fund groups as follows:

- Unrestricted:
 - Operating Fund
The operating fund represents unrestricted resources used to carry out the operations of the Museum.
 - Designated Funds
Designated funds are used to account for monies which have been earmarked for specific purposes by the Board of Trustees.
 - Quasi-Endowment Funds
Quasi-endowment funds (or funds functioning as endowment) represent otherwise spendable unrestricted funds which the Board has chosen to invest for the production of income.
 - Capital Campaign Funds
Capital campaign funds represent funds the Board has designated to apply towards its capital campaign and to account for expenditures related to the campaign.
 - Property Fund
The property fund is designated to account for the acquisition of all land, buildings, equipment and capitalized artifacts of the Museum. These acquisitions are financed by restricted donations or transfers from designated or operating funds.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- Temporarily Restricted Funds:

Temporarily restricted funds are used to account for contributions which have been restricted by donors to certain uses. All other restricted contributions are included in temporarily restricted net assets until the related expenditure is incurred.

- Permanently Restricted/Endowment Funds

Permanently restricted/endowment funds result from donor specifications that the funds be invested in perpetuity and that only the income from these investments be used (Note 13).

Cash and Cash Equivalents

For the purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, cash in bank and cash held in money market funds. Cash held by the investment custodian for the purpose of investing is classified as an investment.

Inventory

Inventory consists of books and other related materials available for sale to members, visitors, and, on occasion, the general public in the Museum's store. Inventory is valued at the lower of cost on a first-in, first-out basis or net realizable value.

Investments

The Museum carries investments in marketable securities with readily determinable fair values and all investments in debt securities at their fair values in the statement of financial position. Investment income and gains and losses on investments are classified as unrestricted net assets unless a donor or law temporarily or permanently restricts their use. Unrealized gains and losses are included in the change in net assets.

Land, Buildings and Equipment

Land, buildings and equipment are carried at cost or, if donated, at fair market value on the date of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

The Museum capitalizes all expenditures on land, buildings and equipment that are greater than \$2,500 and have a useful life in excess of one year.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Historic Land and Buildings

Purchased historic buildings are carried at cost. Donated land and buildings are recorded at the fair market value on the date of donation, if the value is determinable, plus restoration costs.

Historic buildings are considered inexhaustible and, therefore, are not being depreciated due to their historical value.

Inexhaustible Collections

Purchased historic artifacts are capitalized when acquired. Donations of individual gifts valued in excess of \$5,000 are recorded at fair market value at the date of donation. Because the values of the collections existing as of December 31, 1990 are not readily determinable, the Museum has not capitalized them. For the year ended June 30, 2018 the Museum received as contributions 891 items for its library and eight objects of historical significance, each individually valued at less than \$5,000.

The \$1,718,365 in artifacts, which have been recorded on the financial statements, represents only a very small percentage of the estimated total value of the Museum's total artifacts.

Artifacts are considered inexhaustible and, therefore, are not being depreciated due to their historical value. The Museum's artifacts are held for exhibition to the public, for educational purposes or for research, with the intent of being protected, cared for and preserved. Any proceeds from the deaccessioning of collection items will be reinvested in the acquisition of or the protection, care, and preservation of other artifacts in accordance with a policy of the Museum's Board of Trustees.

Recognition of Donor Restrictions

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor or designated by the Board of Trustees. Donor-restricted support is recorded as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets. Unconditional promises to give are recorded when made. Unrecorded promises to give in future years are reported at the present value of their net realizable value using risk free interest rates.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Draw - Operating Fund

Annually, the Board budgets an amount of investment income for designated operating activities. This amount is based upon the average balance of the previous 12 calendar quarters of the market value of invested assets managed by the Museum (See Note 13)

Functional Expenses

The costs of providing program services and supporting services are generally based on direct expenditures incurred. Any expenditures not directly chargeable, such as administration salaries and depreciation, are allocated on the basis of their estimated benefit to the Museum.

Fair Value of Financial Instruments

The fair value of the current assets of the bequests receivable, prepaid expenses, and deposits and the liabilities approximate carrying value because of the short-term nature of these items. The fair value of interest in charitable remainder trusts, which is based on discounted cash flows using current interest rates, approximates the carrying value at June 30, 2018. Investments are held at estimated fair value.

Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses.

Significant estimates used in preparing these financial statements include:

- Net present value of income interests in trusts as determined by using the fair market value of the investments held in the trusts
- The present value of the estimated future value of assets held by charitable remainder trusts
- Collectability of receivables
- Lives and method of depreciating fixed assets
- Allocation of expenses by function
- Fair market value of donated collections

It is at least reasonably possible that the significant estimates used will change within the next year.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comparative Information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP.

Tax Exempt Status

The Museum has been granted tax-exempt status by the Internal Revenue Service and the Franchise Tax Board under code sections 501(c) (3) and 23701d, respectively. Therefore, the Museum is only subject to income tax on unrelated business income. The Museum is not considered a private foundation. The Museum is not aware of any uncertain tax positions at June 30, 2017, or for any year for which the statute of limitations remains open.

Reclassifications

Certain reclassifications have been made to the June 30, 2018, balances as reported in the prior year financial statements to make them comparable to the balances reported for the year ended June 30, 2017.

NOTE 3: INVESTMENTS

Investments are stated at market value, based primarily on quoted market prices for those or similar instruments. The Trustees have engaged two investment advisory firms to manage the investments in accordance with the Museum's investment policy. The cost and market value of investments at June 30 are as follows:

<u>2018</u>	<u>Cost</u>	<u>Market</u>	<u>Unrealized Appreciation</u>
Money Market	\$ 66,224	\$ 66,224	\$ -
Mutual funds	352,436	341,431	(11,005)
Exchange Traded Funds			
Equities	480,816	620,231	139,415
Fixed income	47,255	45,399	(1,856)
Government securities	246,837	237,559	(9,278)
Corporate bonds	72,493	70,894	(1,599)
Common stocks	<u>727,888</u>	<u>955,556</u>	<u>227,668</u>
Total	<u>\$ 1,993,949</u>	<u>\$ 2,337,294</u>	<u>\$ 343,345</u>
Increase in unrealized appreciation over prior year		<u>\$ 71,154</u>	

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 3: INVESTMENTS (Continued)

<u>2017</u>	<u>Cost</u>	<u>Market</u>	<u>Unrealized Appreciation</u>
Money Market	\$ 76,471	\$ 76,471	\$ -
Mutual funds	880,507	966,596	86,089
Government securities	247,620	242,718	(4,902)
Corporate bonds	74,775	75,608	833
Common stocks	<u>721,468</u>	<u>911,639</u>	<u>190,171</u>
Total	<u>\$ 2,000,841</u>	<u>\$ 2,273,032</u>	<u>\$ 272,191</u>
Increase in unrealized appreciation over prior year		<u>\$ 151,972</u>	

Investment income in the statement of activities includes:

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Dividends and interest	\$ 50,572	\$ 49,766
Realized (loss)/gain, net, for the year	78,884	77,043
Less investment advisor fees	<u>(27,045)</u>	<u>(25,378)</u>
Total investment income	<u>\$ 102,412</u>	<u>\$ 101,431</u>

NOTE 4: INTEREST IN CHARITABLE TRUSTS

Charitable trust agreements naming the Museum as an irrevocable beneficiary are recorded on the books of the Museum. Since the Museum is not the trustee for any of the charitable trusts in which it is named as the remainderman, the trusts are recorded as a contribution and an asset equivalent to the present value of the trust assets and estimated future income net of the present value of estimated future payouts to the income beneficiaries. 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.

Charitable Remainder Trusts

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

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 4: INTEREST IN CHARITABLE REMAINDER TRUSTS (Continued)

The assets are recorded at approximate fair market value based upon the most recent tax return filed by the trust which is available to the Museum or current values provided by the settlor to the Museum. The present value of the estimated future value of assets to be received by the Museum is calculated using the IRS annuity tables and a discount rate based on the Museum's historic risk-free rate of return currently estimated at 5%. The estimated value of the charitable remainder trust at June 30, 2018 and 2017, is \$622,819 and \$654,183, respectively.

Charitable Lead Trust

In the prior year, the Museum received notice it is a beneficiary of a charitable lead trust. The Museum will receive a fixed amount initially for 12 years; in addition, the Museum will receive a share of the residual amount. The present value of the estimated value of the assets to be received by the Museum is based upon the Museum's historic risk-free rate of return estimated at 5% and the number of years remaining of the trust. The estimated value of the charitable lead trust at June 30, 2018 and 2017, is \$130,278 and \$138,000, respectively

Additionally, the Museum has been named as a charitable beneficiary in wills and other charitable trusts; however, the donors have retained the right to change charitable beneficiaries. These intentions have not been recorded as assets in these financial statements.

NOTE 5: INTEREST IN PERPETUAL TRUSTS

The Museum is the permanent income beneficiary of the Georgiana Spalding Memorial Trust. The Museum does not have possession or control of the trust, which is held and administered by an outside agent. The market value of the underlying investments held in the trust has been used to estimate the value of the trust. The fair market value of the trust at June 30, 2018, was \$812,665 and at June 30, 2017, was \$830,917. The income received from the trust was \$36,830 and \$43,703 for the years ended June 30, 2017 and 2016, respectively.

The Museum also is the permanent income beneficiary of the "Private Trust" (Santa Barbara Historical Trust Irrev TUA under Agreement). All income from the trust is paid monthly to the Museum, but no payments from the principal are allowed. Wells Fargo Bank is the trustee. The market value of the underlying investments held in the trust has been used to estimate the value of the trust. The fair market value of the trust at June 30, 2018, was \$908,812 and at June 30, 2017, was \$876,556. The income received from the trust was \$10,372 and \$12,087 for the years ended June 30, 2018 and 2017, respectively.

In 2009, the Museum became the permanent income beneficiary of the Yvonne Dibblee Donohoe Fund ("Fund"). The Santa Barbara Foundation is the trustee. The trustee shall remit annually to the Museum 4% of the value of the Fund based upon a rolling average of the market value of the Fund for the previous twelve quarters.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 5: INTEREST IN PERPETUAL TRUSTS (Continued)

The donor restricted expenditures for acquiring objects for the Museum's permanent collection, with preference given to objects from the de la Guerra family. The fair market value of the trust at June 30, 2018, was \$297,518 and at June 30, 2017 was \$297,518. The income received from the trust was \$11,946 and \$12,116 for the years ended June 30, 2018 and 2017, respectively.

NOTE 6: PROPERTY AND EQUIPMENT

Property and equipment are summarized by major classifications, as of June 30 their value is as follows:

	<u>2018</u>	<u>2017</u>
Land	\$ 28,500	\$ 28,500
Buildings and improvement	3,027,944	2,704,442
HVAC System	2,868,343	2,868,343
Gallery fixtures	343,295	343,295
Office equipment	120,734	103,639
Vehicles	11,628	11,628
Furniture and fixtures	85,344	85,344
Software	27,974	27,974
Vault	1,317,956	1,317,956
Security system	71,760	62,277
Costume mannequins	45,088	45,088
	<u>7,948,566</u>	<u>7,598,486</u>
Less accumulated depreciation	<u>(4,463,207)</u>	<u>(4,157,901)</u>
Subtotal	3,477,459	3,440,585
Construction in progress	<u>-</u>	<u>305,650</u>
Property and Equipment - Net	<u>\$ 3,475,359</u>	<u>\$ 3,746,253</u>

Depreciation expense for the years ended June 30, 2018 and 2017 was \$299,486 and \$299,486, respectively. The Museum is progressing with the planned upgrades to its facilities to utilize modern means to preserve its collections (Note 13). The primary projects in the current year consist of completion of renovations for the new Borein Gallery and collection preservation. Projects in the prior year consisted of renovations for the new Borein Gallery. The costs for these projects yet to be completed are included in Construction in Progress.

NOTE 7: HISTORIC LAND AND BUILDINGS

Historic land and buildings at June 30, 2017 and 2016 are \$119,197.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 8: BOARD DESIGNATED AND DONOR RESTRICTED NET ASSETS

Included in the Quasi-Endowment Funds are the following board designated net assets at June 30:

	2018	2017
Library fund	\$ 665	\$ 254
Storke Family fund	99,914	99,914
General - income is designated for:		
Gallery upgrade	259,752	259,752
General operations	1,542,025	11,477,257
Total Quasi-Endowment Funds net assets	\$ 1,902,356	\$ 1,837,177

Temporarily restricted net assets are those which have been restricted by the donor and are available for the following purposes at June 30:

	2018	2017
Library fund	\$ 4,618	\$ 4,618
Curatorial funds	27,287	27,827
Textile conservation and education	69,393	69,393
Borein Gallery	-	-
Borein Publication	100,000	100,000
Children's Hands-on Station	-	-
Directories	1,808	1,808
<i>Noticias</i>	1,500	1,500
Personnel	1,000	1,000
Landscape	14,493	14,493
Exhibit upgrades	37,107	37,107
Technology upgrade	10,000	10,000
Educational programs	72,500	72,500
Charitable remainder and lead trusts	665,459	665,459
Total temporarily restricted net assets	\$ 1,005,166	\$ 1,005,166

Permanently Restricted/Endowment Funds consist of funds invested in perpetuity with the income to be used for the following at June 30:

	2018	2017
Education and outreach	\$ 128,034	\$ 128,034
Collections - capitalized	1,718,365	1,718,365
Endowment for library	25,000	25,000
General operations	89,808	89,808
General operations - held in trust	2,004,990	2,004,990
Charitable remainder trusts	126,724	126,724
Total permanently restricted net assets	\$ 4,092,921	\$ 4,092,921

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 9: CONTRIBUTED SERVICES AND MATERIALS

A significant number of volunteers have contributed their services to the Museum. In accordance with accounting standards only those services provided by professionals have been valued and recorded in these financial statements. During the year ended June 30, 2017, board and committee members contributed approximately 1,130 hours and docents and general volunteers contributed approximately 1,960 hours.

The Museum records, at fair market value, contributions of materials and professional services for which a clearly measurable basis of valuation exists.

NOTE 10: OPERATING LEASES

The museum building is located on land leased from the County of Santa Barbara for one dollar per year until 2061, at which time a new lease can be negotiated. Under the agreement, the Museum assumes all management and control of the premises and all related costs.

NOTE 11: CONCENTRATION OF RISK

Investment Risk

The Museum derives a portion of its earnings from its investments. These investments are subject to the inherent risks of inflation, market fluctuation, volatility, and liquidity.

Geographical

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

Credit Risk

The Museum on occasion has more than \$250,000 on deposit with financial institutions. The Federal Deposit Insurance Corporation (FDIC) only insures the first \$250,000 of funds on deposit in an interest bearing account at any one institution. At June 30, 2017, the Museum had uninsured funds of approximately \$175,000.

Certain of the Museum's investments and cash and cash equivalents are held at two broker-dealers and are subject to Securities Investor Protection Corporation (SIPC). Under SIPC, cash and cash equivalents are insured up to \$250,000 per broker-dealer. On occasion, the Museum's cash balances exceed the insured threshold temporarily.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 12: COMMITMENTS

The Museum has entered into a \$250,000 contract for additional storage capacity as a part of the Vault Upgrade, Phase III. The Museum has undertaken a fundraising campaign to continue into the fiscal year ending 2019 to pay for these costs.

NOTE 13: DONOR AND BOARD DESIGNATED ENDOWMENTS

The Museum-maintained funds in endowments consist of several individual funds established for a variety of purposes. Its endowments include both donor-restricted funds and funds designated by the Board of Trustees to function as endowments. Donor-restricted funds include perpetual trusts in which the Museum is named a beneficiary. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees of the Museum has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Museum classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Museum in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (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, and (7) the Museum's investment policies.

Investment Return Objectives, Risk Parameters and Strategies

The Museum has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide a predictable stream of funding for expansion and for programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income as well as capital appreciation, which exceeds the annual distribution with acceptable levels of risk.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 13: DONOR AND BOARD DESIGNATED ENDOWMENTS (Continued)

Investment Return Objectives, Risk Parameters and Strategies (Continued)

Endowment assets are invested in a well diversified asset mix, which includes equity and debt securities, that is intended to result in a consistent inflation-protected rate of return that has sufficient liquidity to make annual distributions, while growing the funds if possible. Therefore, the Museum expects its endowment assets, over time, to produce an average rate of return of approximately 8% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy

Except for planned capital expenditures, the Museum has a policy of appropriating for distribution each year 5% of its endowment fund's fair value as of June 30 of the preceding fiscal year in which the distribution is planned. In establishing this policy, the Museum considered the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, some of which must be maintained in perpetuity because of donor restrictions, and the possible effects of inflation.

On an annual basis, the Board determines an appropriate amount to be transferred from board designated funds to support operations. In determining the appropriate transfer, the board considers any deficit incurred by the Museum to run its various programs. The Board approves any draw exceeding the 5% budgeted amount. Should unrestricted donations exceed budget, the Museum will not utilize its budgeted draw in order to further the growth of the operating fund.

The Museum expects the current spending policy to allow its endowment funds to grow at a nominal average rate of 3% annually. This is consistent with the Museum's objective to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts and investment return.

Unrestricted Endowment consists of funds not available for operations or withdrawal except by board approval. The endowments include funds not managed by the Museum.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 13: DONOR AND BOARD DESIGNATED ENDOWMENTS (Continued)

Endowment net asset composition within the investments by type of fund, trusts restricted to endowment, and trusts in perpetuity as of June 30, 2018 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted .</u>	<u>Permanently Restricted .</u>	<u>Total Endowment .</u>
Donor- Restricted	\$ -	\$ -	\$ 2,357,198	\$ 2,357,198
Board- Designated	<u>1,620,001</u>	<u>-</u>	<u>-</u>	<u>1,620,001</u>
Total Endowment	<u>\$ 1,620,001</u>	<u>\$ -</u>	<u>\$ 2,357,198</u>	<u>\$ 3,977,199</u>

Endowment net assets as of June 30, 2018 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted .</u>	<u>Permanently Restricted .</u>	<u>Total Endowment .</u>
Endowment Net Assets 6/30/2016	\$ 1,555,233	\$ -	\$ 2,374,556	\$ 3,929,789
Contributions	-	-	-	-
Investment income	102,412	-	-	102,412
Change in value of trusts	-	-	(17,358)	(17,358)
Appreciation/ (depreciation) – unrealized, net	71,154	-	-	71,154
Amounts appropriated for expenditure	<u>(108,798)</u>	<u>-</u>	<u>-</u>	<u>(108,798)</u>
Endowment Net Assets 6/30/18	<u>\$ 1,620,001</u>	<u>\$ -</u>	<u>\$ 2,357,198</u>	<u>\$ 3,977,199</u>

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 13: DONOR AND BOARD DESIGNATED ENDOWMENTS (Continued)

Endowment net asset composition within the investments by type of fund, trusts restricted to endowment, and trusts in perpetuity as of June 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted .</u>	<u>Permanently Restricted .</u>	<u>Total Endowment .</u>
Donor- Restricted	\$ -	\$ -	\$ 2,374,556	\$ 2,374,556
Board- Designated	<u>1,555,233</u>	<u>-</u>	<u>-</u>	<u>1,555,233</u>
Total Endowment	<u>\$ 1,555,233</u>	<u>\$ -</u>	<u>\$ 2,374,566</u>	<u>\$ 3,929,789</u>

Endowment net assets as of June 30, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted .</u>	<u>Permanently Restricted .</u>	<u>Total Endowment .</u>
Endowment Net Assets 6/30/2016	\$ 1,410,510	\$ -	\$ 2,328,503	\$ 3,739,013
Contributions	-	-	-	-
Investment income	101,431	-	-	101,431
Change in value of trusts	-	-	46,053	46,053
Appreciation/ (depreciation) – unrealized, net	151,972	-	-	151,972
Amounts appropriated for expenditure	<u>(108,680)</u>	<u>-</u>	<u>-</u>	<u>(108,680)</u>
Endowment Net Assets 6/30/17	<u>\$ 1,555,233</u>	<u>\$ -</u>	<u>\$ 2,374,556</u>	<u>\$ 3,929,789</u>

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 14: FAIR VALUE MEASUREMENT

The Museum is subject to the provisions of ASC Topic 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Fair value of an investment is the amount that would be received to sell the investment in an orderly transaction between market participants at the measurement date (i.e., the exit price). In accordance with ASU No. 2009-12, *Investment in Certain Entities that Calculate Net Asset Value per Share*, the NAV per share or its equivalent is used to fair value investments that follow the American Institute of Certified Public Accountants Guide in arriving at their reported NAV.

Using the fair value hierarchy established in ASC Topic 820, the Museum is required to maximize the use of observable inputs and to minimize the use of unobservable inputs when measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurements).

The standard describes three levels of inputs that may be used to measure fair value:

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.

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

Common stocks are valued at the closing price reported in the active market in which the individual securities are traded.

Government Securities and Corporate bonds are valued at the closing price in which the individual security or bond is traded.

See Notes 4 and 5 for the methods for calculating the charitable remainder trusts and perpetual trusts.

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 14: FAIR VALUE MEASUREMENT (Continued)

In determining fair value, the Museum utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value. The Foundation held certain assets and instruments that are required to be measured at fair value on a recurring basis at June 30, 2018:

	<u>Quoted Prices in Active Markets for Identical Asset (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Marketable securities held for trading purposes:			
Money market	\$ 66,224	\$ -	\$ -
Mutual funds			
Fixed income	88,387	-	-
Equities	253,044	-	-
Exchange traded funds			
Equities	620,231	-	-
Fixed income	45,399	-	-
Gov't securities	237,559	-	-
Corporate bonds	70,894	-	-
Common stocks	<u>955,555</u>	<u>-</u>	<u>-</u>
Securities subtotal	2,337,293	-	-
Bequests receivable	26,340	-	-
Charitable trusts	<u>-</u>	<u>-</u>	<u>2,659,173</u>
Total	<u>\$ 2,363,633</u>	<u>\$ -</u>	<u>\$ 2,659,173</u>

and at June 30, 2017:

	<u>Quoted Prices in Active Markets for Identical Asset (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Marketable securities held for trading purposes:			
Money market	\$ 76,471	\$ -	\$ -
Mutual funds			
Fixed income	567,230	-	-
Equities	399,366	-	-
Gov't securities	242,718	-	-
Corporate bonds	75,608	-	-
Common stocks	<u>911,639</u>	<u>-</u>	<u>-</u>
Securities subtotal	2,273,032	-	-
Bequests receivable	26,975	-	-
Charitable trusts	<u>-</u>	<u>-</u>	<u>2,659,173</u>
Total	<u>\$ 2,300,007</u>	<u>\$ -</u>	<u>\$ 2,659,173</u>

SANTA BARBARA HISTORICAL MUSEUM

NOTES TO FINANCIAL STATEMENTS

NOTE 14: FAIR VALUE MEASUREMENT (Continued)

The following describes the changes in Level 3 assets from June 30, 2017 to June 30, 2018:

	<u>2018</u>		<u>2017</u>	
	Investment in Perpetual Trusts	Charitable Remainder Trusts	Investment in Perpetual Trusts	Charitable Remainder Trusts
Beginning Balances	\$ 2,004,990	\$ 712,183	\$\$ 1,939,785	\$ 619,905
Contribution – charitable trust to Level 3	-	-	-	138,000
Transfer from Level 3 to Level 2	-	-	-	-
Total gains/ (losses) included in changes in net assets	<u>65,205</u>	<u>34,278</u>	<u>65,205</u>	<u>34,278</u>
Ending Balances	<u>\$ 2,004,990</u>	<u>\$ 654,183</u>	<u>\$ 2,004,990</u>	<u>\$ 792,183</u>

There were no significant transfers between Level 3 and Levels 1 and 2. As explained more fully in Note 5, the Museum is entitled to the income stream from the investment in perpetual trusts.

NOTE 15: CORRECTION OF ERROR

During the course of the audit for the fiscal year ended June 30, 2017, the Museum determined it had been expensing payments for its unemployment reserve rather than treating the amounts as a cash transfer. As a result, the unrestricted net assets at December 31, 2016, have been increased \$23,494 to reflect the recharacterization of the expense to an asset.

NOTE 16: SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 19, 2018, which is the date the financial statements were available to be issued pending final approval by the Board of Trustees. Management has determined no subsequent events requiring disclosure have occurred.

SUPPLEMENTAL INFORMATION