

**The Museum of Art and History
at the McPherson Center**
(A California Public Benefit Corporation)

Financial Statements

June 30, 2020



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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The Museum of Art and History
at the McPherson Center
Santa Cruz, California

We have audited the accompanying financial statements of The Museum of Art and History at the McPherson Center ("MAH," A California Public Benefit Corporation), which comprise the statement of financial position as of June 30, 2020, and 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Museum of Art and History at the McPherson Center as of June 30, 2020, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Change in Accounting Principle

As described in Note 2 to the financial statements, the MAH has adopted Accounting Standards Update ("ASU") 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. Our opinion is not modified with respect to that matter.

Subsequent Event and Uncertainties

As discussed in Note 20 to the financial statements, the economic impact of the spread of the COVID-19 coronavirus has adversely affected the operations at the MAH. However, the related financial impact and duration cannot be reasonably estimated at this time. Our opinion is not modified with respect to that matter.



Armanino^{LLP}
San Jose, California

January 25, 2021

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Statement of Financial Position
June 30, 2020

ASSETS

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Current assets			
Cash and cash equivalents	\$ 1,070,172	\$ 91,894	\$ 1,162,066
Accounts and grants receivable	5,324	270,000	275,324
Rents and trash district fees receivable, net of allowance for doubtful accounts of \$32,500	51,182	-	51,182
Prepaid expenses	12,110	-	12,110
Inventories	<u>42,056</u>	<u>-</u>	<u>42,056</u>
 Total current assets	 <u>1,180,844</u>	 <u>361,894</u>	 <u>1,542,738</u>
 Property, equipment, and improvements, net	 <u>5,530,376</u>	 <u>-</u>	 <u>5,530,376</u>
 Other assets			
Investments	-	368,238	368,238
Unemployment insurance reserve	1,566	-	1,566
Straight-line rent receivable	75,894	-	75,894
Beneficial interest in assets held by Community Foundation of Santa Cruz County	<u>46,243</u>	<u>-</u>	<u>46,243</u>
 Total other assets	 <u>123,703</u>	 <u>368,238</u>	 <u>491,941</u>
 Total assets	 <u>\$ 6,834,923</u>	 <u>\$ 730,132</u>	 <u>\$ 7,565,055</u>

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

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Statement of Financial Position (continued)
June 30, 2020

LIABILITIES AND NET ASSETS

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Current liabilities			
Current portion - note payable	\$ 125,299	\$ -	\$ 125,299
Refundable advance, Paycheck Protection Program	81,898	-	81,898
Accounts payable	42,074	-	42,074
Tenant and facilities rental deposits	28,125	-	28,125
Deferred revenue	68,899	-	68,899
Accrued personal time off	44,504	-	44,504
	<u>390,799</u>	<u>-</u>	<u>390,799</u>
Non-current liabilities			
Note payable	266,701	-	266,701
	<u>657,500</u>	<u>-</u>	<u>657,500</u>
Net assets			
Without donor restrictions			
Undesignated	614,404	-	614,404
Invested in property and equipment, net of related debt	5,138,376	-	5,138,376
Board designated - operating reserve	200,000	-	200,000
Board designated - facilities reserve	201,075	-	201,075
Board designated - publications fund	23,568	-	23,568
Total net assets without donor restrictions	<u>6,177,423</u>	<u>-</u>	<u>6,177,423</u>
With donor restrictions			
Time and use restricted	-	497,061	497,061
Donor-restricted endowment	-	233,071	233,071
Total net assets with donor restrictions	<u>-</u>	<u>730,132</u>	<u>730,132</u>
Total net assets	<u>6,177,423</u>	<u>730,132</u>	<u>6,907,555</u>
Total liabilities and net assets	<u>\$ 6,834,923</u>	<u>\$ 730,132</u>	<u>\$ 7,565,055</u>

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

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Statement of Activities and Changes in Net Assets
For the Year Ended June 30, 2020

	Without Donor Restrictions	With Donor Restrictions	Total
Revenue and other support			
Contributions and grants	\$ 226,756	\$ 200,000	\$ 426,756
Contributions Paycheck Protection Program	176,831	-	176,831
Contracts Santa Cruz County historic preservation	154,594	-	154,594
Memberships	139,346	-	139,346
Museum admissions	41,258	-	41,258
Program service fees	62,589	-	62,589
Facility rental income	110,633	-	110,633
Museum store sales, net of direct costs	8,156	-	8,156
Interest and dividend income	4,568	9,210	13,778
Revenue and other support - fiscal sponsor	126,537	-	126,537
Realized and unrealized gains on investments, net of investment expenses	722	7,196	7,918
Net assets released from restrictions	984,888	(984,888)	-
Total revenue and other support	2,036,878	(768,482)	1,268,396
Other income			
McPherson Center rental and trash service	957,148	-	957,148
Expenses related to rents and trash service	(561,600)	-	(561,600)
Total other income	395,548	-	395,548
Total revenue, support and other income	2,432,426	(768,482)	1,663,944
Expenses			
Program services			
Art and History Museum	1,632,769	-	1,632,769
Supporting services			
Management and general	468,992	-	468,992
Development	131,157	-	131,157
Total supporting services expenses	2,232,918	-	2,232,918
Transfer restricted funds and net assets to sponsored organization	661,806	-	661,806
Total expenses and transfer	2,894,724	-	2,894,724
Change in net assets	(462,298)	(768,482)	(1,230,780)
Net assets, beginning of year	6,639,721	1,498,614	8,138,335
Net assets, end of year	\$ 6,177,423	\$ 730,132	\$ 6,907,555

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

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Statement of Functional Expenses
For the Year Ended June 30, 2020

	Program Services	Management and General	Development	McPherson Center	Total
Personnel	\$ 894,803	\$ 209,211	\$ 99,039	\$ 48,000	\$ 1,251,053
Professional services	43,555	140,276	8,170	-	192,001
Administration and facility	97,027	81,544	1,575	264,085	444,231
Insurance	14,042	35,024	-	15,246	64,312
Interest expense	-	-	-	18,763	18,763
Marketing and promotion	24,966	29	1,502	-	26,497
Property taxes	-	-	-	49,773	49,773
Fundraising and memberships	854	85	18,378	-	19,317
Exhibitions and collections	71,439	-	-	-	71,439
Programs	46,134	354	24	-	46,512
Fiscal sponsored organization expenses	165,263	-	-	-	165,263
Other expenses	22,078	-	-	-	22,078
Depreciation	252,608	2,469	2,469	133,233	390,779
Bad debts	-	-	-	32,500	32,500
	1,632,769	468,992	131,157	561,600	2,794,518
Less expenses included with other income as expenses related to rents	-	-	-	(561,600)	(561,600)
	\$ 1,632,769	\$ 468,992	\$ 131,157	\$ -	\$ 2,232,918
Plus expenses included with revenue and other support					
Museum store sales cost of goods sold					1,276
					\$ 2,234,194

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

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Statement of Cash Flows
For the Year Ended June 30, 2020

Cash flows from operating activities	
Change in net assets	\$ (1,230,780)
Adjustments to reconcile change in net assets to net cash used in operating activities	
Depreciation	390,779
Realized and unrealized gains on investments	(7,918)
Straight-line rental income	(4,662)
Change in assets and liabilities	
Accounts and grants receivable	(43,261)
Rents and trash district fees receivable	(43,240)
Prepaid expenses	(2,543)
Accounts payable	(22,505)
Refundable advance, Paycheck Protection Program	81,898
Tenant and facilities rental deposits	(175)
Deferred revenue	(25,120)
Accrued personal time off	(4,410)
Cash used in operating activities	<u>(911,937)</u>
Cash flows from investing activities	
Net purchase of investments, reinvestment of income	(1,096)
Proceeds from transfers out of U.S. Treasury Bills	499,857
Purchase of property, equipment, and improvements, including CIP	(13,743)
Cash provided by investing activities	<u>485,018</u>
Cash flows from financing activities	
Proceeds from investments - distributions from endowment fund, and community foundation	1,925
Principal payments on debt	(120,264)
Cash used in financing activities	<u>(118,339)</u>
Net decrease in cash, cash equivalents, and restricted cash	(545,258)
Cash, cash equivalents, and restricted cash at beginning of year	<u>1,707,324</u>
Cash, cash equivalents, and restricted cash at end of year	<u>\$ 1,162,066</u>
<u>Supplemental disclosure of cash flow information</u>	
Interest paid	<u>\$ 18,763</u>

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

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

1. General Information

The Museum of Art and History at the McPherson Center ("MAH") is a nonprofit organization, incorporated as A California Public Benefit Corporation, that operates under the direction of its Board of Trustees ("Board"). The MAH's objectives and purposes include exploring diverse cultural ideas, issues and perspectives through artistic experience and regional history. Dedicated to excellence, the MAH provides accessible programs, exhibits, resources and services for exploration, education and research; collection and preservation of works of art and regional historic resources; and development and maintenance of public awareness and appreciation.

The MAH receives a substantial amount of support from donations from individuals and businesses located in Santa Cruz County, which is affected by the local economy. Additional sources of revenue include grants from foundations and a contract with the County of Santa Cruz.

Included in the financial statements is the activity of the History Forum, a supporting organization. The income from that organization provides additional sources of funding for the MAH.

The McPherson Center consists of two components: 1) Museum building, housing the exhibit and administrative offices of The Museum of Art and History, and 2) Office/Retail Building, containing approximately 23,873 square feet of office and retail space.

The initial funding mix for the project consisted of the following:

Economic Development Administration of The United States - Economic Adjustment Assistance Award in the amount of \$1,920,000 and California Department of Commerce local match of \$640,000.

Capital lease from Santa Cruz County in the amount of \$2,255,000 at an annual interest rate of 7.1 percent.

Major Fundraising Campaign - The predecessors, the Art Museum of Santa Cruz County and the History Museum of Santa Cruz County, under their joint venture agreement, raised \$3,590,006 toward the project.

Significant subcommittees of the Board responsible for overseeing certain aspects of the MAH are: 1) Finance Management Committee, responsible for preparing annual budgets for Board approval and related tasks; 2) Center Management Committee, responsible for physical plan management and leasing and operation of the Office/Retail building; and 3) Development Committee, responsible for guiding MAH efforts for contribution and membership growth.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies

Financial statement presentation

The financial statements are presented on the accrual basis of accounting and in conformity with accounting principles generally accepted in the United States of America applicable to not-for-profit organizations. Revenues are reported as increases in net assets without donor restrictions unless there are donor-imposed purposes and/or time restrictions on the gifted assets. Expenses are reported as decreases in net assets without donor restrictions. Gains or losses on investments and other assets or liabilities are reported as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulation.

Change in Accounting Principles

The MAH adopted the following accounting pronouncements in the current year.

Financial Accounting Standards Board ("FASB") Accounting Standards Update (ASU) 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, which provides guidance to be used to determine when a transaction should be accounted for as a contribution or an exchange transaction, and whether a contribution is conditional or unconditional. The MAH adopted ASU 2018-08 as of July 1, 2019 and has applied the amendments of this standard on a modified prospective basis only to agreements that were not completed as of that date. Based on MAH's review of its grants and contracts, the timing and amount of revenue recognized previously is consistent with how revenue is recognized under this new standard. The adoption of ASU 2018-08 had no impact on the statement of financial position and the statement of activities and changes in net assets.

FASB ASU 2016-18, *Statement of Cash Flows (Topic 230)*. This ASU enhances and clarifies the guidance on the classification and presentation of restricted cash in the statement of cash flows and requires additional disclosures about restricted cash balances. The MAH adopted ASU 2016-18 on June 30, 2020. The adoption of ASU 2016-18 did not have a significant impact on the financial statements of the MAH.

New accounting standards not yet adopted.

The FASB issued ASU 2020-05 *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842)*, that grants a one-year effective date delay for certain companies and organizations applying the revenue recognition and leases guidance. Under ASU 2020-05, the MAH has elected to apply:

Topic 606 Revenue guidance for its annual reporting periods beginning after December 15, 2019 (fiscal year beginning July 1, 2020); and Topic 842 Lease guidance for its annual reporting periods beginning after December 15, 2021 (fiscal year beginning July 1, 2022). The MAH is currently in the process of evaluating the impact of the new standards on its financial statements.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Net assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions - Net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. The governing board has designated, from net assets without donor restrictions, net assets as described in Note 10.

Net Assets With Donor Restrictions - Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Gifts of long-lived assets and gifts of cash restricted for the acquisition of long-lived assets are recognized as revenue when the assets are placed in service. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statement of activities and changes in net assets as net assets released from restrictions.

Cash and cash equivalents

For purposes of reporting cash flows, the MAH considers all cash accounts which are not subject to withdrawal restrictions or penalties to be cash or cash equivalents. The MAH maintains its cash and cash equivalents in bank deposit accounts at various financial institutions.

Accounts and grants receivable

Accounts and grants receivable represent amounts owed to the MAH from unconditional promises to give, and conditional promises that have become unconditional, and may be in the form of gifts or grants, and other receivables related to the MAH's programs. The MAH considers all accounts and grants receivable to be fully collectible, accordingly, no allowance for doubtful accounts is considered necessary.

Rents and trash district fees receivable

Rents and trash district fees receivable represents amounts owed to the MAH for McPherson Center tenant rent, triple net charges, and trash district fees based on the terms of the lease agreements.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Rents and trash district fees receivable (continued)

The MAH makes estimates of the collectability of its tenant receivables related to base rents, straight-line rent and triple net charges. The MAH considers such things as historical bad debts, tenant creditworthiness, current economic trends, facility operating performance, lease structure, developments relevant to a tenant's business, and changes in tenants' payment patterns in its evaluation of the adequacy of the allowance for doubtful accounts. As of June 30, 2020, the MAH has made an allowance of \$32,500 for doubtful accounts.

Inventories

Inventories are comprised of program-related books and merchandise held for sale and are stated at the lower of cost or market determined by the first-in, first-out basis.

Property, equipment, and improvements

All property and equipment are stated at cost. Major improvements are charged to the property, equipment and improvements accounts, while maintenance and repairs which do not extend the life for the respective assets are expensed currently. The MAH capitalizes all purchases of property with a cost of \$500 or more and a useful life greater than one year. When property is retired or otherwise disposed of, the cost of the property and the related accumulated depreciation are removed from the accounts and any resulting gains or losses are reflected in income.

Depreciation

Depreciation is computed by use of the straight-line method based on the estimated useful life of the respective assets currently 5-7 years for office furniture and equipment and 15-40 years for building and building improvements.

Investments

The MAH records investment purchases at cost, or if donated, at fair value on the date of donation. Thereafter, investments are reported at their fair values in the statement of financial position. Net investment return/(loss) is reported in the statement of activities and changes in net assets, and consists of interest and dividend income, and realized and unrealized capital gains and losses, less external and direct internal investment expenses.

Investment securities are exposed to various risks, such as changes in interest rates or credit ratings and market fluctuations. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is possible that the value of the MAH's investments and total net assets balance could fluctuate materially.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Investments (continued)

Fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date."

A hierarchy has been established to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). Observable inputs are those that market participants would use in pricing the asset based on market data obtained from sources independent of the MAH. Unobservable inputs reflect the MAH's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

This hierarchy consists of three broad levels:

- Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.
- Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.
- Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the MAH's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Investments – beneficial interest in assets held by Community Foundation of Santa Cruz County

The MAH has transferred net assets without donor restrictions to the Community Foundation of Santa Cruz County which holds funds for MAH's benefit and are invested in a long-term portfolio of assets. Those investments are not covered under FDIC, it is possible that the value of the investments and total net assets balance could fluctuate materially.

When nonprofit organizations transfer assets to a charitable trust or community foundation in which the resource provider names itself as beneficiary, the economic benefit of the transferred asset remains with the resource provider. The asset received in exchange is a beneficial interest in assets held by others, measured at the fair value of the asset contributed.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Investments – beneficial interest in assets held by Community Foundation of Santa Cruz County (continued)

Changes in the value are recognized less investment expenses, in the statement of activities and changes in net assets and included in "realized and unrealized gains on investments, net of investment expenses." Distributions to the MAH from the fund held by the Community Foundation of Santa Cruz County are limited to an annual distribution and may be waived by the MAH. The maximum allowable distribution that can be made is 4% of the average fund balance on the previous 12 quarters, limited to the extent that accumulated earnings are available. Other distributions may be made to the MAH only by a final determination made by the Board of Directors of the Community Foundation of Santa Cruz County.

Revenue and revenue recognition

Revenue is recognized when earned. Program service fees and payments under cost-reimbursable contracts received in advance are deferred to the applicable period in which the related services are performed or expenditures are incurred, respectively. Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a beneficial interest is received. Conditional promises to give are not recognized until the conditions on which they depend have been substantially met. At June 30, 2020 the MAH had no deferred program service revenue.

Membership revenue - The term of the membership is for twelve months. Revenues are amortized into revenue over the membership period. The deferred membership revenue is included in "Deferred revenue" in the "Current liabilities" section on the statement of financial position. As of June 30, 2020, the MAH recognized \$52,930 in deferred membership revenue.

Rental Revenue – The MAH, as a lessor, for leases at The McPherson Center, has retained substantially all of the risks and benefits of ownership and accounts for its leases as operating leases. For lease agreements that provide for scheduled rent increases, rental income is recognized on a straight-line basis over the non-cancellable term of the leases, which commences when control of the space has been provided to the customer. If rental income calculated on a straight-line basis exceeds the cash rent due under a lease, the difference is recorded as an increase to straight-line rent receivable and an increase in rental income. If rental income on a straight-line basis is calculated to be less than cash received, there is a decrease in the same accounts. Contingent rental income, for example additional rent based on the tenant meeting gross revenue benchmarks, is recorded at the time the tenant reaches the applicable benchmarks. When current rent is paid in advance it is recorded in "Deferred revenue" in the "Current liabilities" section in the statement of financial position, deferred rent was \$15,969 as of June 30, 2020. The amount of the straight-line rent receivable included in "Other assets" in the statement of financial position was \$75,894 as of June 30, 2020.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Expenses subject to common area charges

The McPherson Center Office/retail building lease agreements with tenants generally contain provisions that require tenants to reimburse the MAH for certain property expenses. Estimated reimbursements from tenants for real estate taxes, common area maintenance and other recoverable operating expenses are recognized as revenues in the period that the expenses are incurred. Subsequent to year-end, the MAH performs final reconciliations on a lease-by-lease basis and bill or credit each tenant for any cumulative annual adjustments.

Donated materials, services and facilities

Donated services and materials are recorded at their estimated fair value if they enhance the MAH's nonfinancial assets or require specialized skills that the MAH would normally purchase if not provided by donation. No amounts have been reflected in the financial statements for contributed services for the substantial number of volunteers who donate significant amounts of their time in the MAH's program and supporting services, principally in membership development and in the display of exhibits because they did not qualify for recording under generally accepted accounting principle guidelines.

Collections

The MAH acquires its collections through purchase or by donation in-kind. No value has been assigned to the collections on the statement of financial position in accordance with policies followed by art museums and only current year purchases, and not donations in-kind, are reflected in the statement of activities and changes in net assets. The MAH acquires most of its art and historical archival collections through donations. The value of archives acquired through donations is not susceptible to objective valuation and have not been reflected in the financial statements. The collection consists of books, ledgers, clothing, furniture, documents and photographs of items of historical interest, and are managed under the MAH's collection policy.

Estimates

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

Functional expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statement of activities and changes in net assets. The statement of functional expenses

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

2. Summary of Significant Accounting Policies (continued)

Functional expenses (continued)

presents the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include salaries, payroll taxes and employee benefits, which are allocated on the basis of estimates of time and effort, as well as occupancy, utilities, depreciation and amortization, which are allocated on a square footage basis.

Taxes on income

The MAH has received notification from the Internal Revenue Service and the state of California that it qualifies for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and Section 27301(d) of the California Revenue and Taxation Code.

The MAH's federal returns for the tax years ended June 30, 2017 and beyond remain subject to possible examination by the Internal Revenue Service. The MAH's California returns for the tax years ended June 30, 2016 and beyond remain subject to possible examination by the Franchise Tax Board.

The MAH recognizes the effect of income tax positions only if those positions are more likely than not of being sustained, and changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The MAH has evaluated its current tax positions and has concluded that as of June 30, 2020 the MAH does not have any significant uncertain tax positions for which a reserve would be necessary.

3. Front Street Annex Lease

The MAH leases certain real property that houses the commercial and professional space of the McPherson Center under an agreement with the County of Santa Cruz, Amendment No. 1 dated April 9, 2014. Under the agreement rental payments of 10% of gross rent are due on or before September 1 (10% of gross rent from January 1 to June 30) and March 1 (10% of gross rent from July 1 to December 31).

For any six month period for which a use payment has been made (defined as a payment on the debt described in Note 7) such use payment shall satisfy the rental payment obligation.

Rental payments, other than those to be satisfied by a use payment, will commence September 1, 2021.

THE MUSEUM OF ART AND HISTORY AT THE MCPHERSON CENTER
(A California Public Benefit Corporation)
Notes to Financial Statements
June 30, 2020

4. 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, comprise the following:

Cash and cash equivalents	\$ 1,070,172
Accounts and grants receivable	5,324
Rents and trash district fees receivable	51,182
Time restricted net assets available in 2021	<u>120,000</u>
	1,246,678
Less financial assets unavailable for General expenditures due to Board of Trustees designations	<u>424,643</u>
Net available financial assets	<u>\$ 822,035</u>

The MAH, as part of liquidity management, structures financial assets to be available as general expenditures and liabilities, and other obligations become due. Although the MAH does not intend to spend from its Board designated funds, amounts from the Board designated funds could be made available by the Board as necessary. The MAH has an available revolving line of credit, as described in Note 18. The MAH has minimum future payments required on a note payable, as disclosed in Note 7.

5. Concentration of Credit and Market Risk

The MAH maintains its cash and cash equivalents in bank deposit accounts at various financial institutions. The balances at times may exceed federally insured limits. At June 30, 2020, the MAH had \$563,443 in bank deposits in excess of the \$250,000 FDIC limits.

The MAH holds investment funds in various brokerage accounts, and at the Community Foundation of Santa Cruz County, with investments in mutual funds and U.S. treasury bills subject to market risk and interest rate risk.

The MAH is mainly dependent on membership revenue, donations and contributions from the community, grants from private foundations, and net rent revenue from its Office/Retail Building for its operations. The MAH receives a substantial amount of its support from local government. A significant reduction in the level of this support, if this were to occur, may have an effect on the MAH's programs and activities. The MAH's rent income is concentrated in major tenants as disclosed in Note 11.

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6. Property, Equipment, and Improvements

Details of property, equipment and improvements as of June 30, 2020, and related depreciation expense for the year then ended are as follows:

	<u>Museum</u>	<u>McPherson Center</u>	<u>Total</u>
Office furniture	\$ 59,126	\$ 20,406	\$ 79,532
Equipment	349,652	98,828	448,480
Museum store	68,625	-	68,625
Leasehold improvements	346,503	136,888	483,391
Land improvements	-	4,760	4,760
Evergreen Cemetery	81,317	-	81,317
Building use remodel	2,835,104	-	2,835,104
Museum building	3,655,269	-	3,655,269
McPherson Center Building,			
Leasehold improvements			
Front Street Annex	-	4,175,389	4,175,389
	7,395,596	4,436,271	11,831,867
Less: accumulated depreciation	<u>(3,269,703)</u>	<u>(3,031,788)</u>	<u>(6,301,491)</u>
	<u>\$4,125,893</u>	<u>\$1,404,483</u>	<u>\$5,530,376</u>

Depreciation expense for the year ended June 30, 2020 totaled \$390,779 and consisted of \$257,546 included in expenses, and \$133,233 included in expenses related to rents.

7. Note Payable

Note payable at June 30, 2020, consisted of the following:

Santa Cruz County Bank - Entered into on April 29, 2016, as subsequently modified, with a Maturity date of June 30, 2023. Secured by a blanket UCC-1 lien. Due in monthly principal and interest payments of \$11,586 at an at an interest of 4.1 percent.	\$392,000
Less: current portion	<u>(125,299)</u>
	<u>\$266,701</u>

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7. Note Payable (continued)

Minimum future payments are as follows:

<u>Year Ending June 30,</u>	
2021	\$125,299
2022	130,534
2023	<u>136,167</u>
	<u>\$392,000</u>

Interest expense for the year ended June 30, 2020 was \$18,763.

During the year ended June 30, 2016 the MAH obtained the loan from Santa Cruz County Bank in the amount of \$975,000 and paid off the outstanding principal of a capital lease in the amount of \$949,156. The capital lease was payable to Santa Cruz County under an agreement dated March 22, 1993.

8. Paycheck Protection Program Loan

The MAH received loan proceeds of \$258,729 from a promissory note issued by a financial institution, under the Paycheck Protection Program ("PPP") which was established under the CARES Act and is administered by the U.S. Small Business Administration. The terms on the loans are two years and the annual interest rate is 1.00%. Payments of principal and interest are deferred to the date the SBA remits the loan forgiveness amount to the lender or ten months after the loan forgiveness covered period if the borrower has not applied for forgiveness. Under the terms of the CARES Act, PPP loan recipients can apply for and be granted forgiveness for all or a portion of the loans granted under PPP. Such forgiveness will be determined based on the use of the loan proceeds for payroll costs, rent and utility expenses and the maintenance of workforce and compensation levels with certain limitations.

The MAH expects to meet the PPP's eligibility criteria and concludes that the PPP loan represents, in substance, a grant that is expected to be forgiven. As a result the MAH has recognized \$176,831 as government grant revenue to the extent qualifying expenses were incurred through June 30, 2020. The remaining balance of \$81,898 is recognized as a refundable advance as of June 30, 2020 on the statement of financial position and disclosed as a conditional government grant. The MAH plans to submit its forgiveness application during year ended June 30, 2021. The MAH believes that it will likely qualify for full forgiveness, but there is uncertainty around the standards and operation of the PPP, and no assurance is provided that the MAH will obtain forgiveness in whole or in part.

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9. Net Assets With Donor Restrictions

Net assets with donor restrictions are summarized as follows:

	<u>2019</u>	<u>Additions</u>	<u>Released from Restrictions</u>	<u>2020</u>
Donor-restricted endowments to support general activities, subject to spending policy	\$ 233,071	\$ -	\$ -	\$ 233,071
Accumulated earnings	<u>118,761</u>	<u>16,406</u>	<u>-</u>	<u>135,167</u>
	<u>351,832</u>	<u>16,406</u>	<u>-</u>	<u>368,238</u>
Subject to passage of time				
Year ending June 30, 2020	159,496	-	159,496	-
Year ending June 30, 2021	45,000	75,000	-	120,000
Year ending June 30, 2022	<u>14,993</u>	<u>75,000</u>	<u>-</u>	<u>89,993</u>
	<u>219,489</u>	<u>150,000</u>	<u>159,496</u>	<u>209,993</u>
Subject to expenditure for specified purposes				
OFBYFOR ALL	646,408	-	646,408	-
Abbott Square	30,738	-	30,738	-
Evergreen Cemetery	100,000	50,000	-	150,000
Engagement and capacity building	76,205	-	76,205	-
Exhibit	23,770	-	23,770	-
Other	<u>50,172</u>	<u>-</u>	<u>48,271</u>	<u>1,901</u>
	<u>927,293</u>	<u>50,000</u>	<u>825,392</u>	<u>151,901</u>
	<u>\$1,498,614</u>	<u>\$ 216,406</u>	<u>\$ 984,888</u>	<u>\$ 730,132</u>

10. Net Assets Without Restrictions, Board Designated Funds

As of the year ended June 30, 2020, the Board has the following designated funds:

Operating Reserve Fund

During the year ended June 30, 2014, to establish an Operating Reserve Fund, the Board designated \$100,000 of existing accumulated liquid net assets as the beginning balance of the Operating Reserve Fund. The goal was to add \$150,000 to the fund over the next six (6) fiscal years in annual increments of \$25,000. As of June 30, 2020 designated operating reserve was \$200,000.

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10. Net Assets Without Restrictions, Board Designated Funds (Continued)

Facilities Reserve Fund

During the year ended June 30, 2014, the Board determined the need for a Facilities Reserve Fund and created a policy for funding. The Facility Reserve Fund was established at \$233,071. During the year ended June 30, 2017, the Board defunded the reserve in the amount of \$60,000 leaving a remaining reserve of \$161,075. During the year ended June 30, 2019 the reserve was increased by \$40,000 to a current balance of \$201,075.

Publications Fund

The MAH has a Publications Fund for the purpose of setting aside funds for future publications, the balance at June 30, 2020 was \$23,568.

11. Rental Income

McPherson Center rental and trash service fees, for the year ended June 30, 2020, consisted of the following:

Rent	\$ 722,962
Operating costs charges	105,552
Trash district fees	<u>128,634</u>
	<u>\$ 957,148</u>

As of June 30, 2020, rent from three tenants in the office/retail building represented the majority of gross base rent. Concentration percentage of gross base rent from tenants is as follows:

	<u>Percent of Gross Base Rent</u>
Tenant A	36%
Tenant B	27%
Tenant C	12%

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11. Rental Income (continued)

Minimum future rental receipts are due as follows:

<u>Year Ending June 30,</u>	
2021	\$ 624,299
2022	360,928
2023	257,266
2024	237,232
2025	238,619
Thereafter	<u>370,088</u>
	<u>\$2,088,432</u>

12. Employee Benefit Plans

The MAH sponsors a tax-deferred annuity plan ("the Plan") under Section 403(b) of the Internal Revenue Code. The plan covers all employees of the MAH. The MAH has discretion to vary the contribution rate from year to year. For the year ended June 30, 2020, the MAH made no contributions. Employees may make contributions to the plan up to the maximum amount allowed by the Internal Revenue Code if they wish.

13. Related Party Transactions

The following related party transactions occurred between the MAH and/or senior staff: Contributions received for the year ended June 30, 2020 of \$13,578. During the year ended June 30, 2020 the MAH paid \$115,260 to a prior year Trustee for transitional consulting services while the MAH performed a search for a new executive director.

14. Self-Insured for Unemployment Insurance

The MAH is a member of Unemployment Services Trust (UST) which enables the MAH to be self-insured for unemployment claims. As such, the MAH does not pay unemployment taxes directly to the state of California and does not have unemployment insurance. UST acts as the administrator of any claims made against the MAH and specifies the recommended reserve the MAH maintains. The reserve account is held by UST. The MAH has reserved the amount recommended by UST, and at June 30, 2020, the MAH has \$1,566 on deposit with UST as a reserve to fund future claims. The reserve account is included in "Other assets" in the statement of financial position. The MAH could be required to make additional payments if claims exceed the reserve account.

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15. Fair Value Measurements

The following is a description of calculation methodologies used for assets and liabilities recorded at fair value and the basis for estimating fair value. These are reflected as recurring or non-recurring in compliance with required disclosures.

Assets

Investments (Endowment Fund) - Represents assets invested in a mix of funds in a brokerage account.

Beneficial interests in assets held by Community Foundation of Santa Cruz County – are held in an investment pool (Long Term Portfolio).

The following table presents the MAH's fair value hierarchy for those assets measured at fair value as of June 30, 2020:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Endowment fund - exchange traded funds	\$ 368,238	\$ 368,238	\$ -	\$ -
Beneficial interest in assets held by Community Foundation of Santa Cruz County	46,243	46,243	-	-

16. Endowment Fund

As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

Interpretation of relevant law

The Board has interpreted the California version of the Uniform Prudent Management of Institutional Funds Acts (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 MAH retains in perpetuity (a) the original value of gifts donated to the endowment, (b) the original value of subsequent gifts to the endowment, and (c) accumulations to the endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

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16. Endowment Fund (continued)

The remaining portion of the donor-restricted endowment fund that is not held in perpetuity is included in with donor restricted net assets until those amounts are appropriated for expenditure by the MAH in a manner consistent with the standard of prudence prescribed by UPMIFA.

Investment return objectives, risk parameters and strategies

The MAH has adopted investment and spending policies, approved by the Board, for endowment assets. The investment policy seeks to maintain fund principal and provide a reasonable rate of return. Safety of principal and preservation of capital is based on prudent investment principles. While short-term stability is desirable, achieving superior long-term returns takes precedence as an investment objective.

Spending policy

The MAH spending policy is to transfer as a distribution to the MAH an amount equal to the annual interest/dividend earnings while leaving market value increase in the fund. Undistributed investment income, including market value increase in the fund, on the funds are classified as with donor restrictions.

Endowment net asset composition

As of June 30, 2020 amounts held in the Endowment Fund at fair value totaled \$368,238, and consisted of the following:

	<u>2020</u>
Donor-restricted for general operations	\$ 233,071
Net unrealized gains, net of distributions	<u>135,167</u>
Ending balance	<u>\$ 368,238</u>

17. Fiscal Sponsorship

In January 2019, the Board voted to spin off the OF/BY/FOR ALL program into a standalone organization and to serve as its fiscal sponsor until its tax-exempt status under Section 501(c)(3) of the Internal Revenue Code was received.

Under a fiscal sponsorship agreement, the MAH held with donor restricted net assets on behalf of OF/BY/FOR ALL and accepted tax-exempt donations on its behalf. All grants and donations to OF/BY/FOR ALL that were held by the MAH were designated and restricted as such.

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17. Fiscal Sponsorship (continued)

During the year ended June 30, 2020 OF/BY/FOR ALL received its tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, and MAH transferred the remaining OF/BY/FOR ALL with donor restricted net assets and OF/BY/FOR ALL net assets to OF/BY/FOR ALL. As of June 30, 2020 the MAH holds no net assets for OF/BY/FOR ALL.

OF/BY/FOR ALL transactions included in the statement of activities and changes in net assets for the year ended June 30, 2020 consist of the following:

Beginning net assets	\$ 54,124
With donor restricted net assets released for time	150,000
With donor restricted net assets released due to equity transfer	496,408
Revenue and other support	126,537
Expenses	<u>(165,263)</u>
Net assets with donor restrictions and net assets transferred to Sponsored organization	<u>\$661,806</u>

18. Revolving Line of Credit

The MAH has an available revolving line of credit for \$250,000, secured with a blanket UCC-1 lien, with a maturity date of July 3, 2021. The reference rate (the Prime rate, currently 3.250%, with an interest rate floor of 4.250%), is added to the margin of 1.000%, resulting current rate of 4.250%. As of June 30, 2020 no balance is due on the line.

19. New Accounting Standards, Not Yet Adopted

The FASB issued an ASU 2020-05 *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842)*, that grants a one-year effective date delay for certain companies and organizations applying the revenue recognition and leases guidance.

Under the ASU, the MAH has elected to apply: the new Revenue guidance under Topic 606 for its annual reporting periods beginning after December 15, 2019 (MAH fiscal year beginning July 1, 2020); and the new Lease guidance under Topic 842 for its annual reporting periods beginning after December 15, 2021 (MAH fiscal year beginning July 1, 2022).

The MAH is currently in the process of evaluating the impact of the new standards on its financial statements.

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20. Subsequent Events and Uncertainties

The MAH's management has evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through January 25, 2021, the date the financial statements became available to be issued. The MAH had the following subsequent events that require disclosure in the financial statements for the year ended June 30, 2020.

COVID-19 impact and consideration: In March 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. Subsequent to June 30, 2020, the pandemic continues to adversely affect the operations at the MAH, including restrictions on our employees' ability to work, and mandated voluntary closure or restriction of the MAH and Abbott Square Market (a major tenant of the McPherson Center). The circumstances surrounding the pandemic could adversely affect the economies and financial markets of the U.S., resulting in an economic downturn that could affect MAH revenue and public support. Included in MAH financial statements is McPherson Center rent income. The pandemic has adversely affected the business of the lessees, and the lessees' ability to make timely rent payments. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration. The MAH expects this matter to negatively impact its operating results. However, the related financial impact and duration cannot be reasonably estimated at this time.