

**SANTA BARBARA FOUNDATION
AND AFFILIATES
COMBINED AND CONSOLIDATED
FINANCIAL STATEMENTS
DECEMBER 31, 2013**

SANTA BARBARA FOUNDATION AND AFFILIATES

DECEMBER 31, 2013

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Santa Barbara Foundation and Affiliates
Santa Barbara, California

We have audited the accompanying combined and consolidated financial statements of the Santa Barbara Foundation and Affiliates (a non-profit organization) which comprise the combined and consolidated statement of financial position as of December 31, 2013, and the related combined and consolidated statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the notes to the combined and consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined and consolidated 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 combined and consolidated 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 combined and consolidated 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 combined and consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined and consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined and consolidated 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 combined and consolidated 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 combined and consolidated 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 combined and consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Santa Barbara Foundation and Affiliates as of December 31, 2013, and the change in its net assets and its cash flows for the year ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the Santa Barbara Foundation and Affiliates' 2012 combined and consolidated financial statements, and we expressed an unmodified opinion on those combined and consolidated financial statements in our report dated May 16, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived. We did not audit the financial statements of The Orfalea Fund as of December 31, 2012, a supporting organization, which statements reflect total assets of \$23,344,019 and total revenues of \$2,128,588 for the year then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the comparative amounts included for The Orfalea Fund, is based solely on the report of the other auditors.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the combined and consolidated financial statements as a whole. The supplementary information listed in the table of contents and shown on pages 26 through 30 is presented for the purposes of additional analysis of the combined and consolidated financial statements rather than to present the financial position, results of operating, and cash flows of the individual organizations, and it is not a required part of the combined and consolidated financial statements. Such information is the responsibility of management and was derived from and related directly to the underlying accounting and other records used to prepare the combined and consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the combined and consolidated financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting records and other records use to prepare the combined and consolidated financial statements or to the combined and consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

Emphasis-of-matter

As referenced in Notes 1, 4, and 5 to the combined and consolidated financial statements, the combined and consolidated statement of financial position includes investments valued at \$96,336,235 (32% of net assets) as of December 31, 2013, whose fair market values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based upon information provided by the investment managers, third-party valuations, and appraisals, and other unobservable inputs.

McGowan Guntermann

September 11, 2014

SANTA BARBARA FOUNDATION AND AFFILIATES

COMBINED AND CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2013

(With Comparative Totals for December 31, 2012)

ASSETS					(Memo)
	Unrestricted	Temporarily Restricted	Permanently Restricted	2013 Total	2012 Total
Current Assets					
Cash and cash equivalents	\$ 22,058,312	\$ 50,000	\$ -	\$ 22,108,312	\$ 20,228,903
Accounts receivable	263,276	-	-	263,276	331,716
Contributions and bequests receivable, current portion	-	3,358,948	51,726	3,410,674	3,712,144
Student loans receivable, current portion	700,000	-	-	700,000	750,000
Other current assets	308,053	-	-	308,053	183,355
Total Current Assets	<u>23,329,641</u>	<u>3,408,948</u>	<u>51,726</u>	<u>26,790,315</u>	<u>25,206,118</u>
Investments	203,895,512	5,163,589	43,784,538	252,843,639	234,861,415
Property and equipment, net	12,858,387	-	-	12,858,387	13,321,999
Other assets					
Contributions and bequests receivable, net of current portion	-	275,941	-	275,941	393,001
Student loans receivable, net of current portion	2,522,710	-	-	2,522,710	2,691,874
Assets held under charitable trust agreements	-	9,776,736	-	9,776,736	9,081,120
Perpetual income interest	-	-	13,655,465	13,655,465	12,502,433
Other non-current assets	-	157,679	-	157,679	165,818
Goodwill	1,250,000	-	-	1,250,000	1,250,000
Total Other Assets	<u>3,772,710</u>	<u>10,210,356</u>	<u>13,655,465</u>	<u>27,638,531</u>	<u>26,084,246</u>
Total Assets	<u>\$ 243,856,250</u>	<u>\$ 18,782,893</u>	<u>\$ 57,491,729</u>	<u>\$ 320,130,872</u>	<u>\$ 299,473,778</u>
LIABILITIES AND NET ASSETS					
Current Liabilities					
Accounts payable and accrued expenses	\$ 717,673	\$ -	\$ -	\$ 717,673	\$ 475,799
Grants payable, current portion	2,166,289	-	-	2,166,289	2,305,737
Note payable, current portion	68,511	-	-	68,511	63,233
Total Current Liabilities	<u>2,952,473</u>	<u>-</u>	<u>-</u>	<u>2,952,473</u>	<u>2,844,769</u>
Other Liabilities					
Grants payable, net of current portion	60,085	-	-	60,085	1,041,676
Note payable, net of current portion	3,470,964	-	-	3,470,964	3,539,626
Liabilities under charitable trust agreements	-	1,935,796	-	1,935,796	1,623,244
Funds held on behalf of others	12,439,995	-	-	12,439,995	6,896,759
Other non-current liabilities	29,826	-	-	29,826	29,826
Total Other liabilities	<u>16,000,870</u>	<u>1,935,796</u>	<u>-</u>	<u>17,936,666</u>	<u>13,131,131</u>
Total Liabilities	18,953,343	1,935,796	-	20,889,139	15,975,900
Net Assets	<u>224,902,907</u>	<u>16,847,097</u>	<u>57,491,729</u>	<u>299,241,733</u>	<u>283,497,878</u>
Total Liabilities and Net Assets	<u>\$ 243,856,250</u>	<u>\$ 18,782,893</u>	<u>\$ 57,491,729</u>	<u>\$ 320,130,872</u>	<u>\$ 299,473,778</u>

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

SANTA BARBARA FOUNDATION AND AFFILIATES

COMBINED AND CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the Year Ended December 31, 2013

(With Comparative Totals for the Year Ended December 31, 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2013 Total	(Memo) 2012 Total
Revenue, Gains, and Other Support					
Contributions and bequests	\$ 18,258,768	\$ 1,381,000	\$ 50,000	\$ 19,689,768	\$ 18,030,337
Less: Contributions raised on behalf of others	<u>(5,148,047)</u>	<u>-</u>	<u>-</u>	<u>(5,148,047)</u>	<u>(816,794)</u>
Total Contributions and bequests	13,110,721	1,381,000	50,000	14,541,721	17,213,543
Interest and dividends	5,157,083	948,024	-	6,105,107	5,622,572
Less: Interest and dividends on behalf of others	<u>(192,314)</u>	<u>-</u>	<u>-</u>	<u>(192,314)</u>	<u>(138,580)</u>
Total Interest and dividends	4,964,769	948,024	-	5,912,793	5,483,992
Realized gain on value of securities	15,345,097	2,820,883	-	18,165,980	4,136,787
Less: Realized gain on behalf of others	<u>(664,696)</u>	<u>-</u>	<u>-</u>	<u>(664,696)</u>	<u>(130,720)</u>
Total Realized gain on value of securities	14,680,401	2,820,883	-	17,501,284	4,006,067
Unrealized gain (loss) on value of securities	6,773,232	(390,962)	-	6,382,270	26,411,490
Less: Unrealized loss on behalf of others	<u>(63,918)</u>	<u>-</u>	<u>-</u>	<u>(63,918)</u>	<u>(407,549)</u>
Total Unrealized gain (loss) on value of securities	6,709,314	(390,962)	-	6,318,352	26,003,941
Change in value of interests in perpetual trusts	-	-	1,153,032	1,153,032	740,438
Change in value of charitable remainder trusts	-	600,026	-	600,026	(121,461)
Charitable remainder trust contributions	-	143,801	-	143,801	513,457
Broadcasting (net of expenses of \$769,340 and \$830,449)	<u>(300,767)</u>	<u>-</u>	<u>-</u>	<u>(300,767)</u>	<u>(373,601)</u>
Rental (net of expenses of \$617,917 and \$694,709)	<u>(177,726)</u>	<u>-</u>	<u>-</u>	<u>(177,726)</u>	<u>(154,662)</u>
Other income	262,572	-	-	262,572	220,393
Net assets released from restrictions	<u>4,499,558</u>	<u>(4,049,558)</u>	<u>(450,000)</u>	<u>-</u>	<u>-</u>
Total Revenue, Gains and Other Support	<u>43,748,842</u>	<u>1,453,214</u>	<u>753,032</u>	<u>45,955,088</u>	<u>53,532,107</u>
Expenses					
Program services:					
Grants, net of rescinds	22,686,386	-	-	22,686,386	24,628,221
Less: Grants made on behalf of others	<u>(426,512)</u>	<u>-</u>	<u>-</u>	<u>(426,512)</u>	<u>(161,287)</u>
Total Grants, net of rescinds	22,259,874	-	-	22,259,874	24,466,934
Activities:					
Grant making	899,406	-	-	899,406	860,595
Direct program	<u>3,379,983</u>	<u>-</u>	<u>-</u>	<u>3,379,983</u>	<u>3,710,466</u>
Total Program Services	26,539,263	-	-	26,539,263	29,037,995
Support services:					
Administrative and fund management	2,378,086	-	-	2,378,086	4,968,167
Fundraising and development	<u>1,293,884</u>	<u>-</u>	<u>-</u>	<u>1,293,884</u>	<u>1,073,884</u>
Total Support Services	3,671,970	-	-	3,671,970	6,042,051
Total Expenses	<u>30,211,233</u>	<u>-</u>	<u>-</u>	<u>30,211,233</u>	<u>35,080,046</u>
Change in Net Assets	13,537,609	1,453,214	753,032	15,743,855	18,452,061
Net Assets, January 1	<u>211,365,298</u>	<u>15,393,883</u>	<u>56,738,697</u>	<u>283,497,878</u>	<u>265,045,817</u>
Net Assets, December 31	<u>\$ 224,902,907</u>	<u>\$ 16,847,097</u>	<u>\$ 57,491,729</u>	<u>\$ 299,241,733</u>	<u>\$ 283,497,878</u>

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

SANTA BARBARA FOUNDATION AND AFFILIATES

COMBINED AND CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended December 31, 2013

(With Comparative Totals for the Year Ended December 31, 2012)

Expenses	Program Services			Support Services		Total 2013	(Memo) Total 2012
	Grants	Grant Making Activities	Direct Program Activities	Administrative and Fund Management	Fundraising and Development		
Grants, net of rescinds	\$ 22,259,874	\$ -	\$ -	\$ -	\$ -	\$ 22,259,874	\$ 24,466,934
Salaries	-	544,764	1,208,192	927,621	652,846	3,333,423	3,596,952
Employee benefits	-	115,603	503,443	291,693	138,596	1,049,335	902,393
Direct program activities	-	-	734,010	-	-	734,010	870,962
Professional services	-	5,559	381,669	242,212	19,541	648,981	723,380
Investment management fees	-	-	-	377,519	-	377,519	283,455
Community relations	-	20,895	74,355	37,939	138,003	271,192	162,707
Payroll taxes	-	40,103	97,464	80,596	48,089	266,252	281,451
Meetings and conferences	-	29,664	116,924	43,861	36,021	226,470	486,994
Depreciation	-	60,268	-	88,058	73,182	221,508	147,318
Rent	-	2,114	42,313	116,572	2,567	163,566	157,530
Office supplies	-	12,889	72,681	24,414	17,028	127,012	94,044
Computer services	-	22,081	37,701	32,970	26,812	119,564	84,210
Advertising	-	-	7,939	637	79,503	88,079	61,871
Occupancy costs	-	12,602	3,479	34,146	15,302	65,529	54,081
Insurance	-	4,671	19,672	27,042	5,505	56,890	29,853
Provision for bad debts	-	-	50,000	-	-	50,000	75,000
Telephone	-	5,636	11,116	16,871	6,843	40,466	37,561
Dues, subscriptions and licenses	-	5,235	16,677	8,677	6,357	36,946	42,023
Publications	-	8,469	-	2,823	16,939	28,231	35,094
Equipment and maintenance	-	6,543	2,348	9,354	7,945	26,190	74,904
Miscellaneous	-	2,310	-	15,081	2,805	20,196	69,175
Impairment of goodwill	-	-	-	-	-	-	2,342,154
Total Expenses, December 31, 2013	\$ 22,259,874	\$ 899,406	\$ 3,379,983	\$ 2,378,086	\$ 1,293,884	\$ 30,211,233	
Total Expenses, December 31, 2012 (Memo)	\$ 24,466,934	\$ 860,595	\$ 3,710,466	\$ 4,968,167	\$ 1,073,884		\$ 35,080,046

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

SANTA BARBARA FOUNDATION AND AFFILIATES

COMBINED AND CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2013

(With Comparative Totals for the Year Ended December 31, 2012)

	<u>2013</u>	<u>(Memo) 2012</u>
Cash Flows from Operating Activities:		
Change in net assets	\$ 15,743,855	\$ 18,452,061
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	514,708	440,958
Net amortization of premium on investments	198,434	547,396
Realized gain on sale of securities	(17,501,284)	(4,006,067)
Unrealized gain on value of securities	(6,318,352)	(26,003,941)
Provision for bad debts	50,000	75,000
Present value discount and loan forgiveness	102,188	1,561,003
Contributions restricted for long-term investment	(50,000)	(136,435)
(Increase) decrease in:		
Accounts receivable	68,440	75,724
Contributions and bequests receivable	418,530	1,583,761
Goodwill	-	2,342,154
Other current and non-current assets	(116,559)	(27,936)
Assets held under charitable trust agreements	(695,616)	248,474
Perpetual income interest	(1,153,032)	(740,437)
Increase (decrease) in:		
Accounts payable and accrued expenses	241,874	211,026
Grants payable	(1,121,039)	1,223,227
Liabilities under charitable trust agreements	312,552	(146,772)
Funds held on behalf of others	5,543,236	1,268,025
Net Cash Used by Operating Activities	<u>(3,762,065)</u>	<u>(3,032,779)</u>
Cash Flows from Investing Activities:		
Purchase of property and equipment	(19,464)	(20,000)
Purchase of available-for-sale securities	(249,084,567)	(68,399,570)
Proceeds from sale of securities	254,691,913	68,492,200
Student loan disbursements	(738,975)	(699,050)
Student loan repayments	805,951	884,772
Net Cash Provided by Investing Activities	<u>5,654,858</u>	<u>258,352</u>
Cash Flows from Financing Activities:		
Contributions restricted for long-term investment	50,000	136,435
Payments on long-term debt	(63,384)	(50,851)
Net Cash Provided (Used) by Financing Activities	<u>(13,384)</u>	<u>85,584</u>
Net Increase (Decrease) In Cash and Cash Equivalents	1,879,409	(2,688,843)
Cash and Cash Equivalents - January 1	<u>20,228,903</u>	<u>22,917,746</u>
Cash and Cash Equivalents - December 31	<u>\$ 22,108,312</u>	<u>\$ 20,228,903</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the year for interest	\$ 158,520	\$ 208,187
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The accompanying notes are an integral part of these financial statements.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Santa Barbara Foundation (Foundation) is a community foundation incorporated in 1928 under the laws of the state of California as a nonprofit corporation to enrich the lives of the people of Santa Barbara County through philanthropy. As one of the largest private sources of funding for area nonprofits, agencies, and college bound students, the Foundation builds and facilitates philanthropy through donor partnerships; invests in nonprofits to strengthen the nonprofit sector; and identifies and strategically addresses important community needs.

Principles of Combination

The Orfalea Fund was organized in May 2003 as a supporting organization to the Santa Barbara Foundation for the specific and primary purpose of benefiting, performing functions of, and engaging in charitable activities which are consistent with the charitable purposes of the Santa Barbara Foundation. As a result, the accounts of the Orfalea Fund are included in these financial statements.

Highland Santa Barbara Foundation, Inc. was organized in November 2011 as a supporting organization to the Santa Barbara Foundation for the specific and primary purpose of benefiting, performing functions of, and engaging in charitable activities which are consistent with the charitable purposes of the Santa Barbara Foundation. As a result, the accounts of Highland Santa Barbara Foundation, Inc. are included in these financial statements.

The Foundation has eliminated all material inter-organizational accounts and transactions with supporting organizations.

Principles of Consolidation

Pacific Broadcasting Company (KDB) is a wholly owned subsidiary of the Foundation whose primary operating asset is a radio station located in Santa Barbara, CA. As a result, the accounts of KDB are included in these financial statements.

1111 Chapala Street, LLC is a wholly owned subsidiary of the Foundation whose primary operating asset is a commercial building located in Santa Barbara, CA. As a result, the accounts of 1111 Chapala Street, LLC are included in these financial statements.

The Foundation has eliminated all material inter-company accounts and transactions with subsidiaries.

Comparative Amounts

The amounts shown for 2012 in the accompanying financial statements are included to provide a basis for comparison with 2013 and are not intended to present all information necessary for a fair presentation of the 2012 financial statements in conformity with accounting principles generally accepted in the United States of America.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Accounting

The accompanying financial statements of the Foundation have been prepared on the accrual basis of accounting. The Foundation reports information regarding its financial position and activities in three classes of net assets - unrestricted, temporarily restricted, and permanently restricted - based on the existence or absence of donor-imposed restrictions.

The Foundation's governing documents provide the Board of Trustees with the variance power to modify any restriction or condition placed on gifts to the Foundation if, in its sole judgment, the Board of Trustees determine that the restriction becomes in effect unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community served.

Unrestricted Net Assets

Unrestricted net assets represent unrestricted resources available for current support of Foundation activities.

Temporarily Restricted Net Assets

Temporarily restricted net assets consist of contributions and other inflows of funds temporarily subject to donor-imposed restrictions. The restrictions are temporary in that they are expected to expire with the passage of time or be satisfied and removed by actions of the Foundation that fulfill donor stipulations. Temporarily restricted net assets generally include donations received with time restrictions, planned gifts, and contributions and bequests receivable. Earnings on temporarily restricted net assets are reported as an increase in temporarily restricted net assets. Earnings on donor-restricted endowment funds that have not yet been appropriated are also classified as temporarily restricted net assets. When a restriction expires temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as "net assets released from restrictions".

Permanently Restricted Net Assets

Permanently restricted net assets consist of contributions and other inflows of funds subject to donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Foundation. Permanently restricted net assets generally include perpetual interest trusts where the Foundation is not the trustee of the assets. All income related to these trusts are reported as unrestricted contributions when received on the Statement of Activities. The change in value of the underlying assets is recorded as an unrealized gain or loss in permanently restricted net assets on the Statement of Activities. Permanently restricted net assets also consist of those donor-restricted endowments held by the Foundation as defined under the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain amounts and disclosures. Those estimates and assumptions affect the reported amounts of assets, liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. It is at least reasonably possible that the significant estimates could change in the coming year.

Significant estimates used in the preparation of these financial statements include:

- Allocation of certain expenses by function
- Discount factors used in determining contributions and bequests receivable, student loans, grants payable, annuities payable by charitable trust and income interest in charitable trusts
- Allowance for uncollectible student loans and contributions and bequest receivable
- Fair market value of assets held by charitable trusts
- Fair market value of certain investments
- Depreciable lives of property and equipment

Tax Exempt Status

The Foundation is a California nonprofit public benefit corporation, which is exempt from income taxes under Internal Revenue Code Section 501(c)(3) and State of California Revenue and Taxation Code Section 23701(d); therefore, no provision for income taxes is required. The Foundation qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization that is not a private foundation under Section 509(a)(1).

The Foundation and Affiliates evaluate uncertain tax positions, whereby the effect of the uncertainty would be recorded if the outcome was considered probable and reasonably estimable. As of December 31, 2013, the Foundation and Affiliates have no uncertain tax positions requiring accrual.

The Foundation and Affiliates file tax returns in California and U.S. federal jurisdictions. The Foundation is no longer subject to U.S. federal and state tax examinations by tax authorities for years before 2010 and 2009, respectively.

Cash and Cash Equivalents

The Foundation considers all highly-liquid investments with an initial maturity of three months or less to be cash equivalents.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contributions and Bequests

Contributions received are recorded at their fair value on the date of donation. Contributions receivable are recognized as revenue when committed and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met. Bequests are recorded at their estimated fair value when all the events required for the transfer of the assets from the estate of the donor to the Foundation have occurred and/or the court has issued an order to transfer the assets.

Donated Services

Donated goods and services received by the Foundation are recorded at fair market value at the time of the donation. For the year ended December 31, 2013, numerous volunteers gave their time and expertise to the Foundation in a wide variety of areas including committees; administrative activities, technical and financial advice; and office and public relations activities. These contributions, despite their considerable value to the mission of the Foundation, are not reflected in the financial statements.

Investments in Securities

The Foundation records investments in debt and equity securities with readily determinable market values at fair value. The fair value of investments in securities traded on national securities exchanges is valued at the closing price on the last business day of the year. The investments in hedge funds, partnerships and private equity, for which quoted market prices are not readily available, are determined by management in good faith with the assistance of third-party investment managers using methods they consider appropriate. The Foundation defines real assets as investments in real estate and other commodities. Realized and unrealized gains and losses are included in the change in net assets.

Financial Instruments

The Foundation carries certain financial instruments at cost, which approximates fair value.

Donated Property and Investments

Donated property and investments are recorded as contributions at their fair market value at date of receipt.

Property and Equipment

Property and equipment is stated at cost, or fair market value if donated. In general, the Foundation capitalizes assets with a cost of \$5,000 or more and an expected useful life of greater than one year. Depreciation is calculated using the straight-line method over their estimated useful lives as follows:

Building and leasehold	10 – 40 years
Office and equipment	3 – 10 years
Furniture	5 – 10 years

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Funds Held on Behalf of Others

The Foundation receives and distributes assets under certain agency and intermediary arrangements. If a not-for-profit organization (NPO) establishes a fund at the Foundation with its own funds and specifies itself or its affiliate as the beneficiary of that fund, then the Foundation accounts for this transfer of assets by such NPO as a liability. The liability is established at the fair value of the funds, which is generally equivalent to the present value of future payments expected to be made to the NPO and is reflected under "Funds Held on Behalf Others" on the accompanying combined and consolidated statement of financial position.

Grants

Grants are recorded as expenses when they are approved by the Board of Trustees. A discount factor of 5% is applied to grants payable in more than one year. The Foundation records the rescission of grants in the year the grant is cancelled.

Student Loans

Policy

The Foundation provides financial assistance to qualified individuals through its student loan program. Students must attend an accredited two-or four-year college, university, vocational or medical school on a full-time basis. Loans are awarded on need and merit. Loans are interest-free. Repayment begins six months after the student graduates or leaves school.

Allowances for Amounts to Be Forgiven

Prior to 2010, the Foundation forgave one-half of the majority of its student loans if the loan never became delinquent. An allowance was computed for the portion of loans outstanding that would potentially not be collected because they would be forgiven. An annual adjustment to the allowance for amounts to be forgiven reduces the prior year allowance balance by amounts forgiven during the year. In 2010, the Foundation terminated its loan forgiveness policy. Students with loans awarded in 2010 going forward will be expected to repay the full amount.

Allowances for Uncollectible Loans

The Foundation considers its collection history of student loans receivable and provides an allowance for doubtful accounts in the amount which is considered uncollectible. Generally any loan past due for 90 days or more is considered doubtful.

Discount to Present Value

The Foundation discounts the outstanding student loan balance over the estimated repayment period using a 5% rate.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill

Goodwill reflected on the balance sheet represents the goodwill related to the acquisition of KDB (a wholly owned subsidiary) in November 2003. Generally accepted accounting principles require that the value of purchased goodwill be evaluated annually to determine whether the amount reflected on the balance sheet as an asset has been impaired - that is, whether KDB's fair value as a going concern exceeds the carrying value of its net assets, including recorded goodwill. No impairment to the value of goodwill was necessary for the year ended December 31, 2013. The amount of impairment expense for the year ended December 31, 2012 was \$2,342,154 based upon an independent appraisal obtained by management.

Subsequent Events

The Foundation has evaluated subsequent events through September 11, 2014, the date which the financial statements were available to be issued.

Note 2 - CONTRIBUTIONS AND BEQUESTS RECEIVABLE

Unconditional promises are included in the financial statements as contributions and bequests receivable and revenue of the appropriate net asset category. A discount factor of 5% is applied to amounts receivable in more than one year. At December 31, 2013, contributions and bequests receivable are expected to be realized in the following periods:

In one year or less	\$ 3,410,674
In more than one year	393,300
Allowance for discount	<u>(117,359)</u>
Contributions and bequests receivable, net	<u>\$ 3,686,615</u>

Note 3 - STUDENT LOANS RECEIVABLE

Student loans receivable are comprised of the following as of December 31, 2013:

Total student loan balances	\$ 6,164,660
Allowance for amounts to be forgiven	(2,190,663)
Discount to present value	(637,703)
Allowance for uncollectible loans	<u>(113,584)</u>
Net student loans receivable	<u>\$ 3,222,710</u>

Management estimates the student loans receivable will be repaid as follows:

Receivable in less than one year	\$ 700,000
Receivable in one to eight years	2,636,294
Allowance for uncollectible loans	<u>(113,584)</u>
Net student loans receivable	<u>\$ 3,222,710</u>

The student loans are administered by the Scholarship Foundation of Santa Barbara.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - INVESTMENTS

Investments are presented in the financial statements at fair market value. Fair value is defined as the amount that would be exchanged for an asset or to transfer a liability between market participants in an orderly transaction at the balance sheet date. These amounts are not necessarily indicative of the amounts the Foundation could realize in a current market exchange. Realized and unrealized gains and losses on investments are reflected in the Statement of Activities. At December 31, 2013, investments consisted of the following:

	<u>Cost Basis</u>	<u>Market Value</u>	<u>Unrealized Gain (Loss)</u>
Domestic equities	\$ 46,865,915	\$ 54,511,724	\$ 7,645,809
International equities	27,225,256	32,298,570	5,073,313
Domestic fixed income	64,139,194	64,744,590	605,395
International fixed income	3,960,744	3,612,580	(348,164)
Fixed income (illiquid)	23,800,000	48,500,000	24,700,000
Real assets	14,542,196	11,464,379	(3,077,817)
Hedge funds	14,267,586	17,493,631	3,226,045
Private equity	11,605,084	14,758,951	3,153,867
Partnerships	4,415,042	5,459,214	1,044,172
Total	<u>\$ 210,821,017</u>	<u>\$ 252,843,639</u>	<u>\$ 42,022,622</u>

The following summarizes the net change in unrealized gain on investments:

	<u>Cost Basis</u>	<u>Market Value</u>	<u>Unrealized Gain</u>
Balance at end of the year	\$ 210,821,017	\$ 252,843,639	\$ 42,022,622
Balance at beginning of the year	\$ 199,221,063	\$ 234,861,415	\$ 35,640,352
Net change in unrealized gain			<u>\$ 6,382,270</u>

The following summarizes the investment return included as unrestricted revenue and temporarily restricted revenue on donor-restricted endowment funds in the statement of activities for the year ended December 31, 2013:

Investment and dividend income	\$ 6,105,107
Realized gain on value of securities	18,165,980
Unrealized gain on value of securities	6,382,270
Less: investment return allocated to others	(920,928)
Less: investment fees	(377,519)
Net Investment Return	<u>\$ 29,354,910</u>

For the year ended December 31, 2013, approximately 19% of the fair market value of investments and 35% of the investment income were attributable to the Highland Santa Barbara Foundation, Inc. supporting organization's illiquid fixed income position. The amounts are based upon an annual independent third-party valuation using the same techniques and variables as in prior years.

Due to a change in investment advisors for the year ended December 31, 2013, a significant portion of the existing portfolio was liquidated and reinvested into other investment selections. As a result, proceeds from the sale of securities on the Statement of Cash Flows are significantly more in comparison to the previous year.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - FAIR VALUE MEASUREMENT

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurement and Disclosures, provides the framework for measuring and disclosing the fair value of assets and liabilities. Accounting principles define fair value as the price that would be received by the Foundation to sell an asset or be paid by the Foundation to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. A fair value hierarchy has been established that prioritizes valuation inputs into three broad levels to ensure consistency and comparability. The valuation hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3) described as follows:

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; including general partner estimates and recent third-party appraisals.

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

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then Level 2 fair values are estimated by using pricing models quoted prices of securities with similar characteristics or discounted cash flows. The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Fair market valuation of Level 3 securities is based on information provided by fund managers, external investment advisors, and other market factors to determine if the carrying value of these investments should be adjusted. Other factors may include, but are not limited to, estimates of liquidation value, prices of recent transactions in the same or similar funds, current performance, future expectations of the particular investment, and changes in market outlook and the financing environment. Because of the inherent uncertainty of valuations, however, those estimated values may differ from the values that would have been used had a ready market existed, and the differences could be material. Independent appraisals of significant real estate held for investment are conducted at frequencies as determined by the fund manager for valuation purposes. Level 3 securities can include hedge funds, private equity, special purpose vehicles, real assets, and partnerships.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents assets and liabilities recognized in the accompanying Statement of Financial Position measured at fair value on a recurring basis and the level in which the fair value measurements fall at December 31, 2013:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Domestic equities	\$ 54,511,725	\$ -	\$ -	\$ 54,511,725
International equities	32,298,570	-	-	32,298,570
Domestic fixed income	64,744,590	-	-	64,744,590
International fixed income	3,612,580	-	-	3,612,580
Fixed Income (illiquid)	-	-	48,500,000	48,500,000
Real assets	667,765	-	10,796,613	11,464,378
Hedge funds	672,174	-	16,821,457	17,493,631
Private equity	-	-	14,758,951	14,758,951
Partnerships	-	-	5,459,214	5,459,214
Total Investments	<u>156,507,404</u>	<u>-</u>	<u>96,336,235</u>	<u>252,843,639</u>
Perpetual income trusts	13,655,466	-	-	13,655,466
Pooled income funds	717,498	-	-	717,498
Charitable gift annuities	1,538,954	-	-	1,538,954
Charitable trusts, life policy	-	-	6,558,454	6,558,454
Goodwill	-	-	1,250,000	1,250,000
Assets held in trust	<u>1,119,507</u>	<u>-</u>	<u>-</u>	<u>1,119,507</u>
Total assets measured at fair value	<u>\$ 173,538,829</u>	<u>\$ -</u>	<u>\$ 104,144,689</u>	<u>\$ 277,683,518</u>
Charitable trust liabilities measured at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,935,798</u>	<u>\$ 1,935,798</u>

The following is a description of the general classification of investments pursuant to the valuation hierarchy:

Domestic and international equities – includes investment in domestic and international equities of varying market capitalizations represents part of our investment portfolio. Equities are held as separate ownership shares of a specific company or in the form of mutual funds.

Domestic and international fixed income – includes investment in domestic and international fixed income positions is held in the investment portfolio through either individual bond holdings (treasuries, corporate, government, mortgage, etc.) or through fixed income mutual funds.

Fixed Income-Illiquid – includes 100 participation shares in a non-controlling partnership interest composed primarily of collateralized loan obligations. 100% of this investment is held by a supporting organization, Highland Santa Barbara Inc. This partnership interest is illiquid and non-redeemable.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - FAIR VALUE MEASUREMENT (CONTINUED)

Real assets – includes one open-end value added real estate fund that invest primarily in U.S. real estate; and seven limited partnerships which invest in a diverse group of private real estate investment trusts, or similar entities that focus on the acquisition, redevelopment, operation and management of commercial real estate properties; a real asset mutual fund and several real asset fund of funds invested in partnerships focused on natural resources: timber, mining, energy, etc. In 2013, the foundation requested a full redemption from the open-end value added real estate fund. Proceeds from this fund will be paid out as assets are liquidated over a period of years. All of the real asset partnerships illiquid and cannot be redeemed. Unfunded commitments totaled \$3,394,131.

Hedge funds – includes one fund of funds rather than individually separate accounts. Redemptions are in process for two existing funds and were requested for the Access Hedge fund in late 2013. This fund includes multiple investment strategies such as convertible arbitrage, merger arbitrage, long/short, special situations, distressed, global macro, and other strategies to diversify risks and reduce volatility.

Private equity– includes 11 broadly diversified private equity partnerships with varying allocations to buyouts, venture capital, special situations, and secondary funds. Holdings are invested in diversified portfolio of investment partnerships, each of which has a defined term, typically 10-14 years, with no right to withdraw prior to termination of the investment partnership. Funds are called as needed by managers and distributions are received through the liquidation of the underlying assets of the fund. Unfunded commitments totaled \$5,461,223. All of these private equity interests are illiquid and not redeemable.

Partnerships – includes a 24% interest in one partnership that consists of real estate holdings. Distributions from this partnership vary from year to year and are controlled by the general partner. Another partnership of which the Foundation holds a 7.7% interest is comprised of many different partnerships with both domestic and international exposure. This partnership is in the process of liquidation. The foundation has a 48.059 interest in another partnership that was added in 2012. This partnership is comprised of real estate holdings. This partnership interest will terminate in June 2027. All of these partnership interests are illiquid and not redeemable.

The following table provides a reconciliation of assets measured at fair value using significant unobservable inputs (Level 3) for the year ended December 31, 2013:

<u>Description</u>	<u>Beginning Balance</u>	<u>Net Gains and (Losses)</u>	<u>Purchases and Issuances</u>	<u>Sales and Settlements</u>	<u>Ending Balance</u>
Fixed Income - illiquid	\$ 39,600,000	\$ 8,900,000	\$ -	\$ -	\$ 48,500,000
Real assets	11,284,743	295,354	271,143	(1,054,627)	10,796,613
Hedge funds	15,513,804	1,725,006	-	(417,353)	16,821,457
Private equity	14,221,260	1,682,025	453,957	(1,598,291)	14,758,951
Partnerships	5,459,214	-	-	-	5,459,214
Goodwill	1,250,000	-	-	-	1,250,000
Charitable trusts/others	<u>6,089,621</u>	<u>468,833</u>	<u>-</u>	<u>-</u>	<u>6,558,454</u>
Total	<u>\$ 93,418,642</u>	<u>\$ 13,071,218</u>	<u>\$ 725,100</u>	<u>\$ (3,070,271)</u>	<u>\$ 104,144,689</u>

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - FAIR VALUE MEASUREMENT (CONTINUED)

The Foundation has entered into certain agreements for capital commitments to various private limited partnerships investment funds to make future investments in those funds. The outstanding commitments totaled \$8,855,354 as of December 31, 2013. As of December 31, 2013, 100% of the hedge fund positions were in redemption. The remaining illiquid assets valued at \$ 96,336,236 were invested in real assets and real estate, private equity, and private limited partnership investment funds with no ability to redeem the funds except at termination.

The following table sets forth additional disclosures of the organization's investments at Level 3 whose fair market values are estimated using net asset value per share:

<u>Investment</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Fixed Income- illiquid	\$ 48,500,000	\$ -	Non-redeemable	-
Real Assets	10,796,613	3,394,131	Non-redeemable	-
Private Equity Partnerships	14,758,951 5,459,214	5,461,223 -	Non-redeemable Non-redeemable	- -
Hedge Funds:				
Mercer	15,783,086	-	In redemption	-
Silvercreek	924,769	-	In redemption	-
AG Super	<u>113,602</u>	-	In redemption	-
Total	<u>\$ 96,336,235</u>	<u>\$ 8,855,354</u>		

Note 6 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS

A split-interest agreement is a contribution that results in the sharing of legal rights to certain assets by the nonprofit and the donor. The Foundation records such split-interest agreements held in charitable remainder trusts, charitable gift annuities, and pooled income funds as follows:

Charitable Gift Annuities and Pooled Income Funds

Charitable gift annuity donors have contributed assets to the Foundation in exchange for a promise by the Foundation to pay a fixed amount for a specified period of time to the donor or to individuals or organizations designated by the donor. Under the terms of the agreements, no trust exists, as the assets received are held by the Foundation, and the liability is an obligation of the Foundation. The Foundation records new gifts at the fair market value of the assets, less the present value of the estimated future payments to the named beneficiaries. The present value of the payments is calculated using an IRS discount rate in effect at the time of the contract. Subsequent changes in value from prior year are recorded using the fair value of the assets less the present value of the payments expected to be made to the beneficiaries. A discount rate of 5% is used to determine the change in value. The change in value is recorded in the Statement of Activities under changes in value of charitable remainder trusts. The total fair market value of the 46 charitable gift annuities was \$1,538,954 with a corresponding present value liability of \$958,940 at December 31, 2013.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS (CONTINUED)

Charitable Gift Annuities and Pooled Income Funds (continued)

Pooled Income Fund donors have contributed assets to the Foundation in exchange for a net income payout for a specified period of time. Under the terms of the agreements, no trust exists, as the assets are held by the Foundation. The fair market value of the asset is recorded in the Foundation's Statement of Financial Position and a corresponding liability is recorded for the present value of the future payments to the named beneficiaries. Subsequent changes in value from prior year are recorded using the fair value of the assets less the present value of the payments expected to be made to the beneficiaries. The change in value is recorded in the Statement of Activities under changes in value of charitable remainder trusts. The fair market value of the pooled income funds at December 31, 2013, was \$717,498 with a corresponding present value liability of \$237,016.

Charitable Remainder Trusts

The Foundation is named as an irrevocable remainder beneficiary of charitable trusts, which have been established by donors to provide income, generally for life, to designated beneficiaries. The Foundation is also the irrevocable remainder beneficiary of two life insurance policies. At the end of the term, or upon the death of the income beneficiaries, assets remaining in the trusts will be transferred to the Foundation. Each year, beneficiaries receive a percentage of the trust's fair market value, generally limited to net income or net income with make-up provisions.

If the Foundation is the trustee, the fair market value of the trust is recorded in the Foundation's statement of financial position. A corresponding liability is recorded for the present value of the future payments as specified in the trust agreement using a discount rate of 5%. A contribution is recorded for the difference between the two amounts. The fair market value of these six trusts was \$1,119,507 with a corresponding payment liability for future payments of \$739,840 at December 31, 2013.

If the Foundation is not the named trustee and does not exercise control over the assets, contribution revenue and assets are recognized using the fair value of the assets less the present value of the estimated future payments to named beneficiaries. Subsequent changes to the fair value of the assets and liabilities of all trusts are recognized as changes in value of charitable remainder trusts. At December 31, 2013 the net present value of these trusts where the Foundation is not the trustee was \$5,351,686 including both life insurance policies.

The Foundation is named income beneficiary for one charitable lead annuity trust. The trust asset is calculated based on the present value of the expected annual annuity payments over the remaining years. The present value of the trust at December 31, 2013, was \$1,206,770.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS (CONTINUED)

Perpetual Income Trust Interest

The Foundation is named as an income beneficiary of seven perpetual trusts, the corpus of which is not controlled by the management of the Foundation. Under these arrangements, the Foundation has the irrevocable right to receive income earned on the underlying assets held in perpetuity. Income received from four of the trusts is discretionary, while income from one trust is restricted for student aid, and one is restricted for Lompoc area projects. The Foundation also has a future interest in the income of assets yet to be received by one of the above trusts.

Since the Foundation is a beneficiary of this stream of income in perpetuity, the Foundation's share of the fair market value of the trusts' investments is recorded as an asset, with a fair market value of \$13,655,465 at December 31, 2013. Any change in subsequent years in the fair market value of the Foundation's share of the trust investments is recorded in the Statement of Activities as a change in value of interest in trusts.

Note 7 - PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2013, consists of the following:

Building and leasehold improvements	\$ 12,727,739
Land	1,680,000
Loan Fees	38,812
Office equipment	469,658
Donated artwork	17,500
Furniture	244,072
Broadcasting assets	293,652
Automobiles	<u>51,262</u>
Total property and equipment	15,522,695
Less accumulated depreciation and amortization	<u>(2,664,308)</u>
Property and equipment, net	<u>\$ 12,858,387</u>

Note 8 - NOTE PAYABLE

The Foundation refinanced the note payable on the 1111 Chapala Street building in 2011. The new loan, payable to Montecito Bank & Trust, is secured by the property. There are monthly principal and interest payments of \$18,492 at an interest rate of 4.375% with a final balloon payment of \$2,946,063 due on October 20, 2021. Maturities of long-term mortgage for years ended December 31 are as follows:

2014	\$ 68,511
2015	69,088
2016	71,789
2017	75,465
2018	78,882
Thereafter	<u>3,175,740</u>
Total	<u>\$ 3,539,475</u>

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - GRANTS

Future minimum grants payable are as follows for the year ended December 31:

2014	\$ 2,166,289
2015	71,223
2016	<u>22,900</u>
Subtotal	2,260,412
Less Discount	<u>(34,038)</u>
Grants Payable	2,226,374
Less current portion	<u>(2,166,289)</u>
Long-term portion	<u>\$ 60,085</u>

Grant expense is comprised of the following for the years ended December 31:

	<u>2013</u>	<u>2012</u>
Donor advised fund	\$ 6,547,565	\$ 10,771,131
Competitive	3,121,396	2,927,469
The Orfalea Fund	2,585,100	4,247,833
Highland Santa Barbara	1,105,000	331,656
Field of interest	7,239,170	3,941,306
Other	310,940	921,770
Donor designated	<u>1,350,703</u>	<u>1,325,769</u>
Total Grants, net of rescinds	<u>\$ 22,259,874</u>	<u>\$ 24,466,934</u>

Note 10 - CONCENTRATIONS AND RISKS

Credit Risk

The Foundation maintains cash balances at several banks insured by the Federal Deposit Insurance Corporation (FDIC). The Federal Deposit Insurance Corporation (FDIC) only insures the first \$250,000 of funds on deposit at any one institution. The Foundation had uninsured cash of approximately \$10,378,000 deposited with three different banks. In addition, the Foundation maintains significant cash balances in money market funds. Such balances are not fully insured.

Concentrations

For the year ended December 31, 2013, approximately 19% of the fair market value of investments and 35% of the investment income were attributable to the Highland Santa Barbara Foundation, Inc. supporting organization's illiquid fixed income position.

A majority of donors to the Foundation are from Santa Barbara County.

Market Risk

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

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - RELATED PARTY TRANSACTIONS

Santa Barbara Foundation

A majority of trustees and committee members of the Foundation also serve as trustees of entities receiving grants and support from the Foundation. Each trustee and committee member has to complete a conflict of interest declaration form annually. Those trustees and committee members who have conflicts abstain from voting on grants if the beneficiary is one of these entities.

The Orfalea Fund

The Fund shares staff and operating expenses with The Orfalea Family Foundation, a related party. Operating expenses are allocated between the two organizations based on certain agreed upon percentages. In addition, the Fund operates in a building owned by The Orfalea Family Foundation, located in Santa Barbara, California, which is provided to the Fund free of charge. The estimated fair value of this office space for the year ended December 31, 2013 totaled \$113,703 and has been recorded in the statement of activities as in-kind rent income and corresponding rent expense.

Through January 2013, the Fund's staff members were employees of New Resources Consulting, LLC (NRC), a related party owned by two board members. The Fund reimbursed NRC on a regular basis for the cost of their staff and records such reimbursements as payroll, payroll tax, and benefits expense. Subsequent to January 2013, the Fund's staff members became employees of The Orfalea Family Foundation, however, they remained participants in NRC's 401(k) and flexible benefit plans. In addition, the Fund continues to share one employee with NRC. Reimbursements to NRC related to payroll, payroll tax, and benefits expense for the year ended December 31, 2013 totaled \$271,280.

In February 2013, the Fund's staff members became employees of The Orfalea Family Foundation, a related party. The Fund reimburses The Orfalea Family Foundation on a regular basis for the cost of their staff and records such reimbursements as payroll, payroll tax, and benefits expense. Reimbursements related to payroll, payroll tax, and benefits expense for the year ended December 31, 2013 totaled \$1,773,915.

The Fund's investment portfolio is managed by West Coast Asset Management, Inc. (WCAM), a related party partially owned by a board member of the Fund. The Fund obtained proposals from various other investment managers, and determined that the use of WCAM was in the best interest of the Fund. The board member holding an interest in WCAM was excluded from voting on the matter. No investment fees were paid to WCAM for the year ended December 31, 2013. For the year ended December 31, 2013, the estimated fair value of investment services of approximately \$50,000 has not been recorded in the financial statements.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - ENDOWMENT FUNDS

Interpretation of Relevant Law

The Board of Trustees of the Foundation, in concurrence with the advise of legal counsel, has interpreted the California adopted Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring a long-term investment strategy designed to preserve the fair value of the original gift, as of the gift date. As a result of this interpretation, the Foundation has classified with the explicit prohibition by the donor 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 funds that are not classified in permanently restricted net assets are classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard for prudence prescribed by UPMIFA. In accordance with California UPMIFA, the organization considers the following factors in making a determination to appropriate or invest donor restricted endowment funds:

- (1) The duration and preservation of the fund.
- (2) The purposes of the Foundation and the donor-restricted endowment fund.
- (3) General economic conditions.
- (4) The possible effect of inflation and deflation.
- (5) The expected total return from income and the appreciation of investments.
- (6) Other resources of the Foundation.
- (7) The investment policies of the Foundation.

Endowment Investment and Spending Policies

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the long-term purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity for donor-specified periods. The endowment assets are invested in a manner that is intended to produce results that provide a reasonable balance between the quest for growth and the need to protect principal. The investment policy calls for a diversified portfolio utilizing various asset classes with a goal of reducing portfolio volatility and risk.

The Foundation's long-term endowment is invested in a diversified portfolio of domestic equities, international equities, fixed income, and also includes a broad array of alternative investments. The portfolio employs both passive index funds and actively managed funds. The portfolio's objective is to achieve a total return equivalent to or greater than the Foundation's financial requirements over the long-term time horizon. Long-term investment strategies are used to manage risk with the goal to grow charitable dollars overtime. The Foundation also provides three other investment options for donors that have a shorter time horizon and more immediate spending needs.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - ENDOWMENT FUNDS (CONTINUED)

Endowment Investment and Spending Policies (continued)

The Foundation uses a total investment return methodology for determining its spending policy each year. The portfolio's total returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The spending policy calculates the amount of money annually distributed from the Foundation's various discretionary funds and other endowed funds for grant making, student aid, and administrative support. The current spending policy for the year ended December 31, 2013, for discretionary funds was 6%, while other endowed funds were 5%. These percentages are calculated based on a rolling average of the market value for the previous twelve quarters.

The spending policy is reviewed annually in light of changing market assumptions, investment returns and the rate of inflation. Accordingly, over the long term, the Foundation expects current spending policy to allow its endowment assets to grow.

Endowment Funds with Deficiencies

From time to time, the fair value of the assets associated with individual donor-restricted funds may fall below the level that current law requires the Foundation to retain for a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, these deficiencies are reported as a reduction in unrestricted net assets. Such deficiencies may result from unfavorable market fluctuations, particularly if the funds were invested in the endowment pool shortly prior to significant market declines. As of December 31, 2013, the Foundation held six endowment funds where the principal had fallen below the original corpus due to market conditions. The amount of the shortfall totaled \$517,805.

Changes in endowment net assets for the year ended December 31, 2013 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (1,353,020)	\$ 3,736,496	\$ 44,236,264	\$ 46,619,740
Net investment return	1,604,415	3,377,945	-	4,982,360
Contributions	-	-	50,000	50,000
Appropriation of endowment assets for expenditure or transfer	<u>(769,200)</u>	<u>(1,950,852)</u>	<u>(450,000)</u>	<u>(3,170,052)</u>
Endowment net assets, end of year	<u>\$ (517,805)</u>	<u>\$ 5,163,589</u>	<u>\$ 43,836,264</u>	<u>\$ 48,482,048</u>

The Foundation did not classify any assets as board-restricted endowment funds as of December 31, 2013.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - COMMITMENTS

The Foundation has entered into a consulting agreement with a former Foundation executive requiring monthly payments of \$4,000 (\$48,000 per year) for a period of ten years ending December 31, 2018. The total commitment for the consulting agreement as of December 31, 2013 was \$240,000.

Note 14 - RETIREMENT PLANS

Santa Barbara Foundation

Foundation employees over 21 who work at least 1,000 hours per year are eligible to participate in a deferred salary savings plan under Section 403(b) of the Internal Revenue Code after one full calendar month of services. The Foundation matches at its discretion up to 2% of the eligible salary upon participation. For eligible employees with more than one year of service the Foundation at its discretion contributes up to an additional 8% of the participant's eligible salary for a total of 10%. Foundation employer contributions for the year ended December 31, 2013 totaled \$206,845.

In addition, the Foundation has a non-qualified deferred compensation plan. Foundation employer contributions for the year ended December 31, 2013 totaled \$5,833.

The Orfalea Fund

The Fund offers a salary deferral plan as described in Section 401(k) of the Internal Revenue Code (IRC). All employees over the age of 21 who have worked at least 1,000 hours are eligible to participate. Employer contributions to the plan are matching contributions in an amount equal to 100% of employee contributions up to the annual allowable IRC limit. Participants are immediately vested in all contributions and earnings thereon. Employer contributions for the year ended December 31, 2013 totaled \$220,038.

The Fund has a flexible benefit plan that permits participants to elect to receive benefits for themselves and their eligible dependents under various component plans, which provide health, dental, vision, dependent care, adoption assistance, life insurance, and disability benefits. It is intended that the plan qualify under Section 125 of the IRC as a cafeteria plan. Employees are eligible to participate in the plan when hired. The plan includes a flexible spending account option which allows employee contributions through compensation reduction payments. The Fund pays all administrative costs of the plan.

Note 15 - NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from donor restrictions by the passage of time or by satisfying the restricted purposes specified by donors. For the year ended December 31, 2013, net assets released from restriction totaled \$4,499,558.

Note 16 - RECLASSIFICATION

Certain amounts from the December 31, 2012 financial statements have been reclassified to conform to the December 31, 2013 financial statement presentation.

SANTA BARBARA FOUNDATION AND AFFILIATES

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - NET ASSETS

Unrestricted Restricted Net Assets

As of December 31, 2013, unrestricted net assets consist of the following:

Supporting organizations	\$ 62,722,390
Student aid	7,063,896
Donor-advised funds	37,278,294
Field of Interest funds	14,692,931
Donor designated funds	2,882,099
Undesignated funds	100,781,102
Donor-restricted endowment deficit	<u>(517,805)</u>
Total unrestricted net assets	<u>\$ 224,902,907</u>

Temporarily Restricted Net Assets

As of December 31, 2013, temporarily restricted net assets consist of the following:

Pledges receivable	\$ 3,634,889
Split-interest agreements	7,998,619
Donations with time restrictions	50,000
Un-appropriated earnings on endowments	<u>5,163,589</u>
Total temporarily restricted net assets	<u>\$ 16,847,097</u>

Permanently Restricted Net Assets

As of December 31, 2013, permanently restricted net assets consist of the following:

Perpetual interest trusts	\$ 13,655,465
Donor-restricted endowment receivable	51,726
Donor-restricted endowment funds	<u>43,784,538</u>
Total permanently restricted net assets	<u>\$ 57,491,729</u>

Note 18 - SUBSEQUENT EVENTS

On April 2, 2014, an application was tendered with the Federal Communications Commission seeking consent to assignment of the license for Pacific Broadcasting Company (KDB), a wholly owned subsidiary of Santa Barbara Foundation, to the University of Southern California. The application was approved on June 25, 2014. The asset sale was at a price of \$1,300,000. The corporation will be dissolved once the sale is complete.

SUPPLEMENTARY INFORMATION

SANTA BARBARA FOUNDATION

SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL INFORMATION
EXCLUSIVE OF PACIFIC BROADCASTING COMPANY, THE ORFALEA FUND,
1111 CHAPALA STREET, LLC, AND HIGHLAND SANTA BARBARA FOUNDATION, INC.

ASSETS, LIABILITIES, AND NET ASSETS

December 31, 2013 and 2012

	2013	2012
CURRENT ASSETS		
Cash and equivalents	\$ 19,743,853	\$ 17,106,537
Other current assets (Note A)	4,562,780	5,140,527
Total Current Assets	24,306,633	22,247,064
INVESTMENTS	199,649,373	175,119,870
OTHER ASSETS	28,400,989	36,167,997
TOTAL ASSETS	\$ 252,356,995	\$ 233,534,931
LIABILITIES		
Current liabilities	\$ 697,843	\$ 334,695
Other liabilities	14,375,791	8,742,433
Total Liabilities	15,073,634	9,077,128
NET ASSETS	237,283,361	224,457,803
TOTAL LIABILITIES AND NET ASSETS	\$ 252,356,995	\$ 233,534,931

ACTIVITIES AND CHANGES IN NET ASSETS

For the Years Ended December 31, 2013 and 2012

	2013	2012
REVENUE, GAINS, AND OTHER SUPPORT		
Contributions (Note A)	\$ 12,685,646	\$ 16,961,633
Investment income	19,415,691	14,589,795
Other support	3,999,524	2,604,670
Total Revenue, Gains, and Other Support	36,100,861	34,156,098
EXPENSES		
Grants and program expenses	20,505,954	21,705,767
Other expenses	2,769,349	2,944,038
Total Expenses	23,275,303	24,649,805
CHANGE IN NET ASSETS	12,825,558	9,506,293
NET ASSETS, BEGINNING OF YEAR	224,457,803	214,951,510
NET ASSETS, END OF YEAR	\$ 237,283,361	\$ 224,457,803

Note A - The Orfalea Fund grants to the Santa Barbara Foundation for the year ended December 31, 2013 and 2012 totaled \$0 and \$300,000, respectively. As of December 31, 2013 and 2012, pledges receivable from the Orfalea Fund totaled \$188,000 and \$356,000, respectively. These amounts have been eliminated in combination.

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

THE ORFALEA FUND

SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL INFORMATION

ASSETS, LIABILITIES, AND NET ASSETS

December 31, 2013 and 2012

	2013	2012
CURRENT ASSETS		
Cash and equivalents	\$ 1,966,837	\$ 2,925,067
Other current assets	231,973	263,984
Total Current Assets	<u>2,198,810</u>	<u>3,189,051</u>
INVESTMENTS	14,566,213	20,141,545
PROPERTY AND EQUIPMENT, NET	<u>9,028</u>	<u>13,423</u>
TOTAL ASSETS	<u>\$ 16,774,051</u>	<u>\$ 23,344,019</u>
LIABILITIES		
Current liabilities	\$ 2,296,845	\$ 2,606,663
Other liabilities	136,323	1,005,194
Total Liabilities (Note B)	<u>2,433,168</u>	<u>3,611,857</u>
NET ASSETS	<u>14,340,883</u>	<u>19,732,162</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 16,774,051</u>	<u>\$ 23,344,019</u>

ACTIVITIES AND CHANGES IN NET ASSETS

For the Years Ended December 31, 2013 and 2012

	2013	2012
REVENUE, GAINS, AND OTHER SUPPORT		
Contributions	\$ 239,853	\$ 952,520
Investment income	21,634	1,015,499
Other support	149,872	160,569
Total Revenue, Gains, and Other Support	<u>411,359</u>	<u>2,128,588</u>
EXPENSES		
Grants and program expenses (Note B)	5,167,539	6,971,528
Other expenses	635,099	654,384
Total Expenses	<u>5,802,638</u>	<u>7,625,912</u>
CHANGE IN NET ASSETS	(5,391,279)	(5,497,324)
NET ASSETS, BEGINNING OF YEAR	<u>19,732,162</u>	<u>25,229,486</u>
NET ASSETS, END OF YEAR	<u>\$ 14,340,883</u>	<u>\$ 19,732,162</u>

Note B - The Orfalea Fund grants to the Santa Barbara Foundation for the year ended December 31, 2013 and 2012 totaled \$0 and \$300,000, respectively. As of December 31, 2013 and 2012, pledges receivable from the Orfalea Fund totaled \$188,000 and \$356,000, respectively. These amounts have been eliminated in combination.

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

PACIFIC BROADCASTING COMPANY

SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL INFORMATION

ASSETS, LIABILITIES, AND EQUITY

December 31, 2013 and 2012

	2013	2012
CURRENT ASSETS		
Cash and equivalents	\$ 32,229	\$ 13,415
Other current assets	74,911	71,664
Total Current Assets	107,140	85,079
 OTHER ASSETS	 1,273,272	 1,257,278
 TOTAL ASSETS	 \$ 1,380,412	 \$ 1,342,357
 LIABILITIES	 \$ 146,993	 \$ 58,171
 EQUITY	 1,233,419	 1,284,186
 TOTAL LIABILITIES AND EQUITY	 \$ 1,380,412	 \$ 1,342,357

REVENUE AND EXPENSE

For the Years Ended December 31, 2013 and 2012

	2013	2012
REVENUE AND OTHER INCOME		
Broadcasting income	\$ 468,573	\$ 456,049
 EXPENSES (2012 includes goodwill impairment of \$2,342,154)	 769,340	 3,171,802
 NET LOSS	 (300,767)	 (2,715,753)
 EQUITY, BEGINNING OF YEAR	 1,284,186	 3,689,581
 CONTRIBUTIONS	 250,000	 310,358
 EQUITY, END OF YEAR	 \$ 1,233,419	 \$ 1,284,186

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

1111 CHAPALA STREET, LLC

SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL INFORMATION

ASSETS, LIABILITIES, AND EQUITY

December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CURRENT ASSETS		
Cash and equivalents	\$ 54,363	\$ 81,862
Other current assets	<u>339</u>	<u>339</u>
Total Current Assets	<u>54,702</u>	<u>82,201</u>
PROPERTY AND EQUIPMENT, NET	<u>11,115,569</u>	<u>11,407,170</u>
TOTAL ASSETS	<u>\$ 11,170,271</u>	<u>\$ 11,489,371</u>
LIABILITIES	\$ 3,652,690	\$ 3,703,452
EQUITY	<u>7,517,581</u>	<u>7,785,919</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 11,170,271</u>	<u>\$ 11,489,371</u>

REVENUE AND EXPENSE

For the Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
REVENUE AND OTHER INCOME		
Rent	\$ 629,849	\$ 634,640
Common area reimbursements	<u>180,856</u>	<u>160,085</u>
Total Revenue and Other Income	<u>810,705</u>	<u>794,725</u>
EXPENSES		
Common area expenses	115,297	136,308
Interest	158,520	208,187
Other expenses	52,499	58,612
Depreciation and Amortization	<u>291,601</u>	<u>291,602</u>
Total Expenses	<u>617,917</u>	<u>694,709</u>
NET INCOME	192,788	100,016
EQUITY, BEGINNING OF YEAR	7,785,919	8,333,244
DISTRIBUTIONS	<u>(461,126)</u>	<u>(647,341)</u>
EQUITY, END OF YEAR	<u>\$ 7,517,581</u>	<u>\$ 7,785,919</u>

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

HIGHLAND SANTA BARBARA FOUNDATION, INC.

SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL INFORMATION

ASSETS, LIABILITIES, AND NET ASSETS

December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH AND EQUIVALENTS	\$ -	\$ -
INVESTMENTS	<u>48,500,000</u>	<u>39,600,000</u>
TOTAL ASSETS	<u>\$ 48,500,000</u>	<u>\$ 39,600,000</u>
LIABILITIES	\$ 118,493	\$ 3,229
EQUITY	<u>48,381,507</u>	<u>39,596,771</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 48,500,000</u>	<u>\$ 39,600,000</u>

ACTIVITIES AND CHANGES IN NET ASSETS

For the Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
REVENUE AND GAINS		
Investment income	\$ 10,295,104	\$ 16,822,156
EXPENSES		
Program	1,355,000	1,016,656
Management and general	<u>155,368</u>	<u>126,368</u>
Total Expenses	<u>1,510,368</u>	<u>1,143,024</u>
CHANGE IN NET ASSETS	8,784,736	15,679,132
NET ASSETS, BEGINNING OF YEAR	<u>39,596,771</u>	<u>23,917,639</u>
NET ASSETS, END OF YEAR	<u>\$ 48,381,507</u>	<u>\$ 39,596,771</u>

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