

**SAUSALITO ARTS FESTIVAL FOUNDATION  
DECEMBER 31, 2007 AND 2006**



**KROHN AND GODBY**  
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS OF  
SAUSALITO ARTS FESTIVAL FOUNDATION

We have audited the accompanying statements of financial position of Sausalito Art Festival Foundation (a nonprofit organization) as of December 31, 2007 and 2006, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the financial statements, the Foundation reports its investment in Sausalito Art Festival LLC, a majority-owned subsidiary, on the equity method of accounting. In our opinion accounting principles generally accepted in the United States of America require that all majority-owned subsidiaries be accounted for as consolidated subsidiaries. As of December 31, 2007, Sausalito Art Festival, LLC was dissolved and its remaining cash and operating assets and liabilities were distributed to Sausalito Art Festival Foundation, which are included in the accompanying financial statements. If the financial statements of the Sausalito Art Festival LLC had been consolidated with those of the Sausalito Art Festival Foundation, total assets and total liabilities would be unchanged as of December 31, 2007 and would be increased by \$16,033 as of December 31, 2006; and revenues and expenses would be increased by \$297,090 and \$126,099 for the years ended December 31, 2007 and 2006.

In our opinion, except for the effects of not consolidating all majority-owned subsidiaries, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Sausalito Art Festival Foundation as of December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

San Francisco, California

March 11, 2008

SAUSALITO ART FESTIVAL FOUNDATION  
 Statements of Financial Position  
 December 31, 2007 and 2006

ASSETS		<u>2007</u>	<u>2006</u>
Current Assets			
Cash and cash equivalents	\$	518,769	\$ 201,431
Accounts Receivable		3,029	-
Prepaid expenses		<u>11,985</u>	<u>-</u>
Total Current Assets		<u>533,783</u>	<u>201,431</u>
Other Assets			
Investment in Sausalito Art Festival LLC		-	245,776
Deposits		2,500	-
Trademarks, copyright and goodwill		<u>887,922</u>	<u>-</u>
Total Other Assets		<u>890,422</u>	<u>245,776</u>
Total Assets	\$	<u><u>1,424,205</u></u>	\$ <u><u>447,207</u></u>

LIABILITIES AND NET ASSETS

Current Liabilities			
Accounts payable	\$	537	\$ 2,981
Accrued liabilities		<u>9,903</u>	<u>-</u>
Total Current Liabilities		<u>10,440</u>	<u>2,981</u>
Long-Term Liabilities			
Note payable		<u>787,922</u>	<u>-</u>
Total Long-Term Liabilities		<u>787,922</u>	<u>-</u>
Net Assets			
Unrestricted		<u>625,843</u>	<u>444,226</u>
Total Liabilities and Net Assets	\$	<u><u>1,424,205</u></u>	\$ <u><u>447,207</u></u>

SAUSALITO ART FESTIVAL FOUNDATION  
 Statements of Activities  
 For the Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Revenues and Other Support		
Gala ticket sales	\$ 146,100	\$ 149,299
Income from Sausalito Art Festival LLC	297,465	126,099
Interest	<u>6,635</u>	<u>1,831</u>
Total Revenue and Other Support	<u>450,200</u>	<u>277,229</u>
Functional Expenses		
Gala expense	149,549	180,458
General and administrative	14,034	25,289
Settlement of legal dispute with Sausalito Chamber of Commerce	-	75,000
Final payment of license agreement to Sausalito Chamber of Commerce	75,000	-
Scholarships and grants	<u>30,000</u>	<u>47,709</u>
Total Functional Expenses	<u>268,583</u>	<u>328,456</u>
Change in Net Assets	181,617	(51,227)
Net Assets - January 1	<u>444,226</u>	<u>495,453</u>
Net Assets - December 31	<u>\$ 625,843</u>	<u>\$ 444,226</u>

SAUSALITO ART FESTIVAL FOUNDATION  
 Statements of Cash Flows  
 For the Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash Flows from Operating Activities:		
Increase (Decrease) in net assets	\$ 181,617	\$ (51,227)
Adjustments to reconcile increase in net assets to cash provided by (used in) operating activities:		
Income from investment in Sausalito Art Festival LLC	(297,465)	(126,099)
Decrease in related party receivable	-	31,078
Decrease in accounts payable	(2,981)	(14,585)
Increase in accrued liabilities	<u>2,903</u>	<u>-</u>
Net Cash Used In Operating Activities	<u>(115,926)</u>	<u>(160,833)</u>
Cash Flows from Investing Activities:		
Distribution from Sausalito Art Festival LLC	533,264	-
Payment on note payable	<u>(100,000)</u>	<u>-</u>
Net Cash Provided by Investing Activities	<u>433,264</u>	<u>-</u>
Net Increase (Decrease) in Cash	317,338	(160,833)
Cash at Beginning of Year	<u>201,431</u>	<u>362,264</u>
Cash at End of Year	<u>\$ 518,769</u>	<u>\$ 201,431</u>

Supplemental disclosure of noncash investing activity:

The Foundation's majority-owned subsidiary, Sausalito Art Festival, LLC was dissolved as of December 31, 2007 and the remaining operating assets and liabilities were distributed to the Foundation. The remaining operating assets and liabilities at December 31, 2007 were as follows:

Receivables	\$ 3,029	
Prepaid expenses	11,985	
Deposits	2,500	
Accounts payable	(537)	
Accrued expenses	<u>(7,000)</u>	
Net noncash distribution	<u>\$ 9,977</u>	

SAUSALITO ART FESTIVAL FOUNDATION  
Notes to Financial Statements  
December 31, 2007 and 2006

**NOTE 1 - ORGANIZATION**

Sausalito Art Festival Foundation (the Foundation) is a non-profit corporation whose specific purpose is to participate in and promote the growth of the annual Sausalito Art Festival and related activities in support of the arts and art education.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Accounting policies in general conform to accounting principles generally accepted in the United States of America.

Accounting method - The books of account and the financial statements are based on the accrual basis of accounting.

Cash Equivalents - The Company classifies all operating cash accounts, time deposits, and certificates of deposit as cash and cash equivalents. The Company maintains its cash balances at several high-credit quality financial institutions in California. Cash balances, at times, can be in excess of Federal Deposit Insurance Corporation insurance limits.

Revenue recognition - The Company recognizes its revenue when earned.

Income Taxes - The Foundation is exempt from paying income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code. The Foundation is also classified as an organization that is not a private foundation under Section 509(a)(2).

Use of estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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.

**NOTE 3 - CONCENTRATION OF CREDIT RISK**

The Foundation's annual income is materially based on three days of revenue generated through the annual festival.

**NOTE 4 - INVESTMENT IN SUBSIDIARY**

The Foundation had an investment in a majority-owned subsidiary, the Sausalito Art Festival, LLC (the LLC), which the Foundation has accounted for using the equity method of accounting. The LLC's primary operations involved the production of the three-day annual art festival in Sausalito, California. The members included the Foundation and the Sausalito Chamber of Commerce (the Chamber). The Foundation managed the planning, operations and administration of the annual art festival. The Chamber granted to the LLC an exclusive license to its copyright in the trademark "The Sausalito Art Festival", shared information it had accumulated from prior art festivals and subleased to the Company its rights to the real property on which the festival is held under a license between the Chamber and the City of Sausalito.

In December 2007, the Foundation purchased the Chamber's interest in the LLC along with its copyright in the trademark "The Sausalito Art Festival" and all related marks, proprietary information and trade secrets used the production of the festival. The LLC was then dissolved and the remaining cash and operating assets and liabilities were distributed to the Foundation, which will continue to produce the annual art festival.

The most recent audited financial summary of the Sausalito Art Festival LLC for the years ended December 31, 2007 and 2006, is as follows:

	<u>2007</u>	<u>2006</u>
Total assets	\$ -	\$ 261,809
Total liabilities	-	16,033
Member's Equity	-	245,776
Revenues	1,488,942	1,309,016
Expenses	1,191,477	1,182,917
Net income	\$ 297,465	\$ 126,099

**NOTE 5 - INTANGIBLE ASSET PURCHASE**

As noted above, in December 2007 the Foundation acquired the interest of the Sausalito Chamber of Commerce in Sausalito Art Festival, LLC and also purchased the Chamber's copyright in the trademark "The Sausalito Art Festival" and all related marks, proprietary information and trade secrets used for the production of the festival. The LLC interest and related intangible assets were acquired by the Foundation in exchange for a non-interest bearing note in the amount of \$1,300,000. The Foundation has discounted the face value of the note in accordance with Accounting Principles Board Opinion No. 21, *Interest on Receivables and Payables* using an interest rate of 7%, which results in a present value of \$887,922.

**NOTE 6 - NOTE PAYABLE**

The Foundation issued a non-interest bearing note payable to the Sausalito Chamber of Commerce with a face value of \$1,300,000 in exchange for the assets purchased as described in Note 5. The Foundation has discounted the note using an interest rate of 7%, resulting in a discount of \$412,078 and present value of \$887,922. The payment terms of the note are one payment of \$100,000 due at the time the purchase agreement was executed and twelve annual payments of \$100,000 with the next payment due by January 31, 2009. The terms of the note stipulate that the amount of the annual payment may decrease if gross revenues from the art festival are less than 7% of the average gross revenues for the three preceding years. Any decrease in the annual payment amount is added to the subsequent year's payment, but in no event shall the annual payment exceed \$100,000, which may require the Foundation to make payments beyond the thirteen year period.

**NOTE 7 - RELATED PARTY TRANSACTIONS**

For the years ended December 31, 2007 and 2006, the Foundation received payments from Sausalito Art Festival, LLC for tickets to the Foundation's annual Gala event, which the LLC then distributed to certain artists and sponsors of the art festival. The total amount received by the Foundation from the LLC was \$30,000 and \$35,000 for 2007 and 2006, respectively.

During 2007 the Foundation purchased \$4,197 in goods and services from businesses affiliated or controlled by members of the managing board of the Foundation. These purchases were made under the same terms of arm's length transactions in the operation of those businesses.

**NOTE 8 - EMPLOYEE RETIREMENT PLAN**

The Foundation is adopting a 401(k) retirement plan formerly maintained by Sausalito Art Festival, LLC that allows voluntary contributions by eligible employees. Employees may elect to contribute up to the maximum allowed under the Internal Revenue Service regulations.

SAUSALITO ART FESTIVAL FOUNDATION  
Notes to Financial Statements  
December 31, 2007 and 2006

**NOTE 9 - OPERATING LEASE OBLIGATION**

The Foundation is assuming a lease obligation of Sausalito Art Festival, LLC for office space. The terms of the original lease and an extension agreement executed in December 2007 provide for monthly lease payments of \$2,500 through January 2008 with the payments increasing to \$3,869 per month from February 2008 through May 2009.

**NOTE 10 - SUBSEQUENT EVENT**

In January 2008, the Foundation entered into a license agreement with the City of Sausalito that allows it to use the real property on which the art festival is held annually in exchange for collecting and remitting the business license fees for the artists and vendors participating in the festival. The initial term of the license agreement is five years and includes two options to extend for an additional five years each.