

Houston Grand Opera Association, Inc.

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended July 31, 2009 and 2008

Independent Auditors' Report

To the Board of Directors of
Houston Grand Opera Association, Inc.:

We have audited the accompanying consolidated statements of financial position of the Houston Grand Opera Association, Inc. as of July 31, 2009 and 2008 and the related consolidated statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the Houston Grand Opera Association, Inc.'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 our audits 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Houston Grand Opera Association, Inc. as of July 31, 2009 and 2008 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating statements of financial position as of July 31, 2009 and 2008 and the consolidating statements of activities for the years then ended are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position or changes in net assets of the individual companies. These statements have been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, are fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Blazek & Vetterling

November 11, 2009

Houston Grand Opera Association, Inc.

Consolidated Statements of Financial Position as of July 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash	\$ 495,755	\$ 456,456
Accounts receivable, net of allowance of \$3,183 in 2009 and \$188,333 in 2008	147,143	221,929
Pledges receivable, net (<i>Note 2</i>)	10,853,022	10,958,419
Deferred production costs and other assets	1,599,456	1,754,257
Investments (<i>Notes 3 and 4</i>)	34,146,787	41,087,418
Property, net (<i>Note 5</i>)	<u>1,069,603</u>	<u>1,330,585</u>
TOTAL ASSETS	<u>\$ 48,311,766</u>	<u>\$ 55,809,064</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 553,736	\$ 519,040
Accrued salaries and benefit costs	206,569	276,141
Co-production payable	44,912	84,856
Note payable (<i>Note 6</i>)	2,780,000	1,500,000
Deferred subscription revenue	2,396,952	2,338,446
Deferred co-production and set rental revenue	<u>151,817</u>	<u>419,310</u>
Total liabilities	<u>6,133,986</u>	<u>5,137,793</u>
Commitments and contingencies (<i>Note 7</i>)		
Net assets:		
Unrestricted	(2,119,646)	(1,168,899)
Temporarily restricted (<i>Note 8</i>)	13,055,466	21,156,784
Permanently restricted (<i>Notes 9 and 10</i>)	<u>31,241,960</u>	<u>30,683,386</u>
Total net assets	<u>42,177,780</u>	<u>50,671,271</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 48,311,766</u>	<u>\$ 55,809,064</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statement of Activities for the year ended July 31, 2009

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Contributions	\$ 8,450,378	\$ 3,592,940	\$ 558,574	\$ 12,601,892
Ticket sales and performance fees	3,609,028			3,609,028
Special events	1,487,901	172,630		1,660,531
Co-production and other income	795,308			795,308
Investment return, net (<i>Note 3</i>)	(397,436)	(4,170,142)		(4,567,578)
Cost of direct donor benefits	<u>(652,838)</u>	<u> </u>	<u> </u>	<u>(652,838)</u>
Total revenue	13,292,341	(404,572)	558,574	13,446,343
Net assets released from restrictions:				
Endowment transfer for operations	3,065,455	(3,065,455)		
Expiration of time restrictions	3,837,598	(3,837,598)		
Redesignation for special event	<u>793,693</u>	<u>(793,693)</u>	<u> </u>	<u> </u>
Total	<u>20,989,087</u>	<u>(8,101,318)</u>	<u>558,574</u>	<u>13,446,343</u>
EXPENSES:				
Program services	14,898,170			14,898,170
Marketing and advertising	2,759,409			2,759,409
Fundraising	2,704,993			2,704,993
Management and general	<u>1,577,262</u>			<u>1,577,262</u>
Total expenses	<u>21,939,834</u>			<u>21,939,834</u>
CHANGES IN NET ASSETS	(950,747)	(8,101,318)	558,574	(8,493,491)
Net assets, beginning of year	<u>(1,168,899)</u>	<u>21,156,784</u>	<u>30,683,386</u>	<u>50,671,271</u>
Net assets, end of year	<u>\$ (2,119,646)</u>	<u>\$ 13,055,466</u>	<u>\$ 31,241,960</u>	<u>\$ 42,177,780</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statement of Activities for the year ended July 31, 2008

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Contributions	\$ 8,470,110	\$ 6,041,279	\$ 1,116,935	\$ 15,628,324
Ticket sales and performance fees	4,669,555			4,669,555
Special events	1,873,771	388,094		2,261,865
Co-production and other income	473,802			473,802
Investment return, net (<i>Note 3</i>)	(69,645)	(1,887,850)		(1,957,495)
Cost of direct donor benefits	<u>(540,813)</u>	<u> </u>	<u> </u>	<u>(540,813)</u>
Total revenue	14,876,780	4,541,523	1,116,935	20,535,238
Net assets released from restrictions:				
Endowment transfer for operations	2,996,808	(2,996,808)		
Expiration of time restrictions	2,513,312	(2,513,312)		
Redesignation for special event	<u>505,062</u>	<u>(505,062)</u>	<u> </u>	<u> </u>
Total	<u>20,891,962</u>	<u>(1,473,659)</u>	<u>1,116,935</u>	<u>20,535,238</u>
EXPENSES:				
Program services	14,005,083			14,005,083
Marketing and advertising	2,624,424			2,624,424
Fundraising	2,702,961			2,702,961
Management and general	<u>1,750,431</u>			<u>1,750,431</u>
Total expenses	<u>21,082,899</u>			<u>21,082,899</u>
CHANGES IN NET ASSETS	(190,937)	(1,473,659)	1,116,935	(547,661)
Reclassification of net assets (<i>Note 10</i>)	(14,668,799)	14,668,799		
Net assets, beginning of year	<u>13,690,837</u>	<u>7,961,644</u>	<u>29,566,451</u>	<u>51,218,932</u>
Net assets, end of year	<u>\$ (1,168,899)</u>	<u>\$ 21,156,784</u>	<u>\$ 30,683,386</u>	<u>\$ 50,671,271</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statements of Cash Flows for the years ended July 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ (8,493,491)	\$ (547,661)
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Net realized and unrealized loss on investments	5,153,829	2,768,307
Contributions restricted for endowment	(558,574)	(1,116,935)
Depreciation	347,514	338,126
Provision for uncollectible pledges receivable	115,998	100,000
Change in discount on pledges receivable	(158,646)	72,284
Changes in operating assets and liabilities:		
Accounts receivable	74,786	283,409
Pledges receivable (operating)	87,545	(3,807,143)
Deferred production cost and other assets	154,801	(478,315)
Accounts payable and accrued expenses	(34,876)	415,228
Co-production payable	(39,944)	(100,066)
Deferred revenue	<u>(208,987)</u>	<u>(205,235)</u>
Net cash used by operating activities	<u>(3,560,045)</u>	<u>(2,278,001)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(10,655,273)	(9,068,632)
Proceeds from sale of investments	15,232,272	11,494,475
Net change in cash and money market mutual funds held as investment	(2,790,197)	(1,112,117)
Purchases of property	<u>(86,532)</u>	<u>(337,071)</u>
Net cash provided by investing activities	<u>1,700,270</u>	<u>976,655</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from note payable	7,455,000	5,550,010
Payments on note payable	(6,175,000)	(5,200,010)
Proceeds from contributions restricted for endowment	<u>619,074</u>	<u>912,435</u>
Net cash provided by financing activities	<u>1,899,074</u>	<u>1,262,435</u>
NET CHANGE IN CASH	39,299	(38,911)
Cash, beginning of year	<u>456,456</u>	<u>495,367</u>
Cash, end of year	<u>\$ 495,755</u>	<u>\$ 456,456</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest paid	\$132,726	\$96,547

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 2009 and 2008

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization – The Houston Grand Opera Association, Inc. (the Association) was founded in 1955 to promote and provide suitable opportunities for the advancement of musical culture by producing, sponsoring, or otherwise making available to the general public music theater performances including grand opera, light opera, operetta, musical theater, and recitals.

The Association's programs include theater performances, education and outreach, and Houston Grand Opera Studio. Education and outreach initiates and develops educational programs and relationships for children, teachers, and the general public including pre-curtain lectures, artist presentations, high school nights at mainstage performances, and student matinees, and provides for the development of opera education materials and programs for the visually impaired. Houston Grand Opera Studio is a nationally acclaimed training and performance program dedicated to the advancement of young artists with the potential for major careers in the opera, music, and theater profession.

The Houston Grand Opera Guild (the Guild) promotes quality musical drama performances, including grand operas, and provides suitable opportunities for the advancement of musical culture, and instills through education and performances the traditions of opera and music theater in the general public. The Association is the sole member of the Guild. The Houston Grand Opera Endowment (the Endowment) was founded to accumulate and manage a permanent endowment for the purpose of supporting the operations of the Association.

Basis of consolidation – These financial statements include the consolidated statements of financial position, of activities, and of cash flows for the Association, the Guild, and the Endowment (collectively the Opera). All balances and transactions between these consolidated entities have been eliminated.

Federal income tax status – The Association, the Guild, and the Endowment are exempt from federal income taxes under §501(c)(3) of the Internal Revenue Code. The Association and the Guild are classified as public charities under §509(a)(2). The Endowment is classified as a public charity and a Type I supporting organization under §509(a)(3).

Cash – At times, bank deposits exceed the federally insured limit per depositor per institution.

Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Pledges receivable that are expected to be collected in future years are discounted to estimate the present value of future cash flows. Discounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of discounts are included in contribution revenue. It is possible that management's estimate regarding the collectibility of these balances will change in the near term resulting in a change in the carrying value of pledges receivable.

Allowance for doubtful accounts – An allowance for accounts receivable or pledges receivable is provided when it is believed balances may not be collected in full. The amount of bad debt expense recorded each period and the resulting adequacy of the allowance at the end of each period are determined using a combination of historical loss experience and account by account analysis of accounts

receivable and pledges receivable balances each period. It is possible that management's estimate regarding collectibility will change in the near term resulting in a change in the carrying value of accounts receivable and pledges receivable.

Deferred production costs – Expenses for scenery, costumes, music, and stage properties are recorded as deferred production cost if specifically related to productions of future opera seasons.

Investments in marketable securities are recorded at fair value. Investment return is reported in the statement of activities as an increase in unrestricted net assets unless the use of the income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported in temporarily restricted net assets.

Property is recorded at cost, if purchased, or at the fair value at the date of gift, if donated. Buildings, leasehold improvements, and furniture and equipment are depreciated using the straight-line method over estimated useful lives of 5 to 15 years.

Net asset classification – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and investment return restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets. If a restriction is fulfilled in the same time period in which the contribution is received, the Endowment and the Association reports the support as unrestricted.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Investment return may be used to support specified programs.

Contributions are recorded as revenue when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are recorded as restricted support. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Ticket sales and performance fees are recorded as revenue when the performance takes place. Amounts received for future Association season performances are included in the financial statements as deferred subscription revenue.

Co-production revenue – The Association enters into co-production agreements with other opera companies or associations for the purpose of sharing performance production costs. Agreements among multiple parties are structured as royalty or rental compensation to the Association. Co-production revenue is recognized when the Association's contractual obligations are fulfilled.

Non-cash contributions – Donated materials, facilities, and services are recorded at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recorded as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. In-kind contributions of \$771,257 and \$371,337 in 2009 and 2008, respectively, consisting primarily of advertising services, were donated to the Association.

Advertising is expensed the first time the advertising takes place, except for expenditures related to future opera seasons which are recorded as deferred production cost and other assets. Advertising expense was \$641,607 in 2009 and \$413,467 in 2008.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Reclassifications – Certain reclassifications have been made to the prior year financial statements to conform to current year presentations.

NOTE 2 – PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	<u>2009</u>	<u>2008</u>
Due in less than one year	\$ 6,159,943	\$ 6,930,130
Due in one to five years	4,795,855	4,602,625
Thereafter	<u>300,000</u>	<u>325,000</u>
Total pledges receivable	11,255,798	11,857,755
Discount to present value using 1.62% to 5%	(342,776)	(501,421)
Allowance for uncollectible pledges receivable	<u>(60,000)</u>	<u>(397,915)</u>
Pledges receivable, net	<u>\$ 10,853,022</u>	<u>\$ 10,958,419</u>

During 2008, the Association received a \$5 million conditional pledge, of which \$2.5 has been recorded as contributions as of July 31, 2009, as the required benchmark was satisfied. At July 31, 2009, the conditions had not been met for the remaining \$2.5 million contribution and this gift is not recorded in these financial statements. The remaining \$2.5 million requires the Association to cumulatively raise \$45,550,000 by July 31, 2010 for an additional \$1.5 million contribution, \$62,150,000 by July 31, 2011 for an additional \$500,000 contribution, and \$76,650,000 by July 31, 2012 for an additional \$500,000 contribution.

NOTE 3 – INVESTMENTS

Investments consist of the following:

	<u>2009</u>	<u>2008</u>
Domestic equity securities	\$ 10,232,847	\$ 11,449,408
Fixed income common collective trust fund	7,822,002	10,909,033
Commingled equity funds	5,006,288	12,981,426
Money market mutual funds	4,625,684	3,235,487
Equity mutual fund	2,592,584	
Fixed income mutual fund	1,686,458	
Cash	1,400,000	
International equity securities	574,153	2,157,242
Private energy partnership	<u>206,771</u>	<u>354,822</u>
Total investments	<u>\$ 34,146,787</u>	<u>\$ 41,087,418</u>

The commingled equity funds are managed by fund managers and are invested in domestic and international publicly traded equities.

Investments are exposed to various risks such as interest rate, market and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

Investment return includes earnings on cash deposits and consists of the following:

	<u>2009</u>	<u>2008</u>
Interest and dividends	\$ 734,917	\$ 970,982
Royalty income	44,027	76,734
Investment fees	(192,693)	(236,904)
Net realized and unrealized loss on investments	<u>(5,153,829)</u>	<u>(2,768,307)</u>
Investment return, net	<u>\$ (4,567,578)</u>	<u>\$ (1,957,495)</u>

NOTE 4 – FAIR VALUE MEASUREMENTS

Effective August 1, 2008, the Opera adopted Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (FAS 157), which provides a framework for measuring fair value of certain assets and liabilities and expands disclosures about fair value measurements. As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy defined by FAS 157 are as follows:

- *Level 1* – Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access as of the reporting date.
- *Level 2* – Inputs other than quoted prices included in Level 1, which are either directly observable or that can be derived from or corroborated by observable data as of the reporting date.
- *Level 3* – Inputs include those that are significant to the fair value of the asset or liability and are generally less observable from objective resources and reflect the reporting entity’s own assumptions about the assumptions market participants would use in pricing the asset or liability.

Assets measured at fair value as of July 31, 2009 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Domestic equity securities	\$ 10,232,847			\$ 10,232,847
Fixed income common collective trust fund			\$ 7,822,002	7,822,002
Commingled equity funds			5,006,288	5,006,288
Cash and money market mutual funds	4,625,684			4,625,684
Equity mutual fund	2,592,584			2,592,584
Fixed income mutual fund	1,686,458			1,686,458
International equity securities	574,153			574,153
Private energy partnership			<u>206,771</u>	<u>206,771</u>
Total assets measured at fair value	<u>\$ 19,711,726</u>	<u>\$ 0</u>	<u>\$ 13,035,061</u>	<u>\$ 32,746,787</u>

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	PRIVATE ENERGY PARTNERSHIP	FIXED INCOME COMMON COLLECTIVE TRUST FUND	COMMINGLED EQUITY FUNDS	TOTAL
Balance at July 31, 2008	\$ 354,822	\$ 10,909,033	\$ 12,981,423	\$ 24,245,278
Net purchases, sales and redemptions	145	(3,378,479)	(4,840,212)	(8,218,546)
Unrealized gain (loss)	(60,767)	261,710	(3,041,417)	(2,840,474)
Realized gain (loss)	<u>(87,429)</u>	<u>29,738</u>	<u>(93,506)</u>	<u>(151,197)</u>
Balance at July 31, 2009	<u>\$ 206,771</u>	<u>\$ 7,822,002</u>	<u>\$ 5,006,288</u>	<u>\$ 13,035,061</u>
				<u>TOTAL</u>

The amount reported in changes in net assets for the year ended July 31, 2009 attributable to realized and unrealized losses related to assets held at year end and measured at fair value using significant unobservable inputs. \$ (2,840,474)

This amount was included in investment return in the accompanying statement of activities for the year ended July 31, 2009.

Valuation methods used for assets measured at fair value are as follows:

- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Fixed income common collective trust fund and commingled equity funds* are valued by the investment manager based on their net asset values and supported by the value of the underlying securities.
- *Mutual funds* are valued at the published net asset value of shares held at year end.
- *Private energy partnership* is valued at the reported net asset value as determined by the issuer and the values reported in the audited financial statements based on the fair value of the underlying investments.

The valuation methods used may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the management believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date. The inputs or methodology used to measure investments are not necessarily indicative of the risk of investing in a particular security.

NOTE 5 – PROPERTY

Property consists of the following:

	<u>2009</u>	<u>2008</u>
Leasehold improvements	\$ 1,907,997	\$ 1,907,997
Production equipment	508,686	1,430,674
Computer equipment	441,514	1,134,296
Furniture and other	115,929	112,700
Office equipment	163,979	257,460
Vehicles	98,278	98,278
Music equipment	53,190	49,790
Modular stage		1,675,000
Scenery		<u>254,967</u>
Total property, at cost	3,289,573	6,921,162
Accumulated depreciation	<u>(2,219,970)</u>	<u>(5,590,577)</u>
Property, net	<u>\$ 1,069,603</u>	<u>\$ 1,330,585</u>

NOTE 6 – NOTE PAYABLE

The Association has a \$6 million unsecured line of credit due February 1, 2010, with interest payable monthly at the bank's prime interest rate plus 2% (5.25% at July 31, 2009). Interest expense was \$132,726 in 2009 and \$96,547 in 2008.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Leases – The Association leases office, storage and rehearsal space, and equipment under noncancellable operating leases. In 1987, the Association entered into a lease on a non-exclusive basis with the City of Houston for the use of the Wortham Center for \$134,000 a year. The initial term of the lease is 30 years and can be renewed for an additional 30-year term. This lease does not have a termination date. Minimum future lease payments, including the lease payment related to the Wortham Center lease for each of the five succeeding fiscal years, are as follows:

2010	\$ 474,958
2011	474,958
2012	468,444
2013	415,780
2014	<u>411,306</u>
Total minimum future lease payments	<u>\$ 2,245,446</u>

Rental expense was approximately \$489,186 in 2009 and \$630,309 in 2008.

Artists' contracts – The Association has entered into compensation contracts with various artists for future performances. If the Association cancels these performances, it may be liable to pay the related

artists all or a portion of the agreed compensation. As of July 31, 2009, such contracts with artists call for potential future compensation as follows:

2010	\$ 4,029,500
2011	2,265,500
2012	1,590,500
2013	<u>762,500</u>
Total	<u>\$ 8,648,000</u>

NOTE 8 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2009</u>	<u>2008</u>
Restricted for future opera productions	\$ 7,587,694	\$ 8,504,207
Accumulated earnings on permanent endowment:		
General operations	4,435,581	10,578,906
Music director chair	427,970	703,400
Studio	297,068	668,762
New productions	150,318	371,726
Spring Opera Festival	107,610	176,660
Education	40,784	141,162
Wagner opera performances	<u>8,441</u>	<u>11,961</u>
Total temporarily restricted net assets	<u>\$ 13,055,466</u>	<u>\$ 21,156,784</u>

NOTE 9 – PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets are invested in perpetuity to support the following:

	<u>2009</u>	<u>2008</u>
General operating endowment	\$ 22,105,586	\$ 21,847,162
Electronic media	2,130,000	2,130,000
Studio	2,006,484	2,006,334
Concert of Arias	1,352,218	1,352,218
Music director chair	1,300,200	1,000,200
New productions	1,257,473	1,257,473
Education	634,149	634,149
Spring Opera Festival	250,000	250,000
New productions with artistic merit	200,000	200,000
Wagner opera performances	<u>5,850</u>	<u>5,850</u>
Total permanently restricted net assets	<u>\$ 31,241,960</u>	<u>\$ 30,683,386</u>

NOTE 10 – ENDOWMENT

Effective August 1, 2008, the Endowment adopted Financial Accounting Standards Board Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP 117-1). FSP 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Additionally, it provides expanded disclosures about an organization's donor-restricted endowment funds and board-designated endowment funds.

The Board of Trustees of the Endowment has interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) 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 Endowment classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Endowment in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, the Endowment considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Opera and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Opera
- The investment policies of the Endowment

The Board of Trustees of the Endowment is charged with preserving the corpus of the endowment, growing the total value of the endowment through investments and gifts, and financially supporting the mission and activities of the Opera.

Spending Policy

Annually, the Endowment will distribute 5% of the average market value of the Endowment's funds under management for the preceding twelve quarters (beginning July 31 of the prior year and preceding quarters). Excluded from funds under management will be any restricted funds that do not qualify as distributable for the upcoming year. In conjunction with the authorization of the annual distribution, the Board of Trustees will review this policy in light of current and expected market conditions and rate of inflation. Other distributions may be made from time to time at the discretion of the Board of Trustees.

Investment Policy

Endowment funds are maintained in investment accounts which are managed by the Endowment Board of Trustees with oversight provided by an independent financial consultant. Investment decisions follow

guidance provided in an investment policy approved by the Board of Trustees. The investment policies attempt to provide a predictable stream of funding to programs supported while seeking to maintain the purchasing power of the endowment assets. The Endowment expects its endowment funds, over time, to provide an average rate of return of approximately five percentage points more than the rate of inflation. To satisfy its long-term rate-of-return objectives, the Endowment relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Endowment targets a diversified asset allocation that places an emphasis on a blend of equity-based investments and fixed income investments to achieve its long-term return objectives within prudent risk constraints.

Changes in net assets of the donor restricted endowment funds are as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, August 1, 2007	\$ 14,668,799	\$ 2,825,234	\$ 29,566,451	\$ 47,060,484
Reclassifications for changes in the law	<u>(14,668,799)</u>	<u>14,668,799</u>	<u> </u>	<u> </u>
Endowment net assets after reclassification	0	17,494,033	29,566,451	47,060,484
Contributions		43,202	1,116,935	1,160,137
Investment return:				
Interest and dividends	6,525	1,038,328		1,044,853
Net realized and unrealized loss	(68,486)	(2,689,274)		(2,757,760)
Investment management fees	<u> </u>	<u>(236,904)</u>		<u>(236,904)</u>
Net investment return	(61,961)	(1,887,850)		(1,949,811)
Expenses	(6,525)			(6,525)
Appropriations for expenditure	<u> </u>	<u>(2,996,808)</u>	<u> </u>	<u>(2,996,808)</u>
Endowment net assets, July 31, 2008	(68,486)	12,652,577	30,683,386	43,267,477
Contributions		50,792	558,574	609,366
Investment return:				
Interest and dividends	800	775,076		775,876
Net realized and unrealized loss	(383,182)	(4,752,525)		(5,135,707)
Investment management fees	<u> </u>	<u>(192,693)</u>		<u>(192,693)</u>
Net investment return	(382,382)	(4,170,142)		(4,552,524)
Expenses	(800)			(800)
Appropriations for expenditure	<u> </u>	<u>(3,065,455)</u>	<u> </u>	<u>(3,065,455)</u>
Endowment net assets, July 31, 2009	<u>\$ (451,668)</u>	<u>\$ 5,467,772</u>	<u>\$ 31,241,960</u>	<u>\$ 36,258,064</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or TUPMIFA requires the Endowment to retain as a fund of perpetual duration. Deficiencies of this nature resulted from unfavorable market fluctuations and are reported in unrestricted net assets as an aggregate deficiency of the fair value of net endowment assets over permanently restricted net assets.

Endowment net asset composition as of July 31, 2009:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
General operating		\$ 4,435,583	\$ 22,105,586	\$ 26,541,169
Studio		297,068	2,006,484	2,303,552
Electronic media	\$ (256,646)		2,130,000	1,873,354
Music director chair		427,970	1,300,200	1,728,170
New productions		150,318	1,257,473	1,407,791
Concert of Arias	(171,352)		1,352,218	1,180,866
Education		40,784	634,149	674,933
Spring Opera Festival		107,610	250,000	357,610
New productions with artistic merit	(23,670)		200,000	176,330
Wagner opera performances		<u>8,439</u>	<u>5,850</u>	<u>14,289</u>
Endowment net assets	<u>\$ (451,668)</u>	<u>\$ 5,467,772</u>	<u>\$ 31,241,960</u>	<u>\$ 36,258,064</u>

Endowment net asset composition as of July 31, 2008:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
General operating		\$ 10,578,906	\$ 21,847,162	\$ 32,426,068
Studio		668,762	2,006,334	2,675,096
Electronic media	\$ (34,992)		2,130,000	2,095,008
Music director chair		703,400	1,000,200	1,703,600
New productions		371,726	1,257,473	1,629,199
Concert of Arias	(30,637)		1,352,218	1,321,581
Education		141,162	634,149	775,311
Spring Opera Festival		176,660	250,000	426,660
New productions with artistic merit	(2,857)		200,000	197,143
Wagner opera performances		<u>11,961</u>	<u>5,850</u>	<u>17,811</u>
Endowment net assets	<u>\$ (68,486)</u>	<u>\$ 12,652,577</u>	<u>\$ 30,683,386</u>	<u>\$ 43,267,477</u>

NOTE 11 – RETIREMENT PLAN

The Association has a defined contribution retirement plan covering substantially all employees who have completed one year of service. In 2009 and 2008, the Association matched 100% of the eligible participating employee's contribution up to 2% of the employee's annual salary. The Association contributed approximately \$68,000 and \$74,000 to the plan in 2009 and 2008, respectively. Effective August 1, 2009, the plan was amended to discontinue the Association's matching contributions.

NOTE 12 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 11, 2009, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that need to be disclosed or would have an impact on reported net assets or change in net assets other than the retirement plan amendment disclosed in Note 11.

Houston Grand Opera Association, Inc.

Consolidating Statement of Financial Position as of July 31, 2009

	ASSOCIATION		ENDOWMENT	GUILD	ELIMINATIONS	TOTAL
	OPERATING FUND	PLANT FUND				
ASSETS						
Cash	\$ 482,842		\$ 11,413	\$ 1,500		\$ 495,755
Accounts receivable, net	147,143					147,143
Pledges receivable, net	9,753,842		1,099,180			10,853,022
Deferred production costs and other assets	1,520,048			79,408		1,599,456
Investments			34,146,787			34,146,787
Property, net		\$ 1,069,583	20			1,069,603
Due from affiliates			1,000,664		\$(1,000,664)	
TOTAL ASSETS	\$11,903,875	\$ 1,069,583	\$36,258,064	\$ 80,908	\$(1,000,664)	\$48,311,766
LIABILITIES AND NET ASSETS						
Liabilities:						
Accounts payable and accrued expenses	\$ 553,736					\$ 553,736
Accrued salaries and benefit costs	206,569					206,569
Co-production payable	44,912					44,912
Note payable	2,780,000					2,780,000
Deferred subscription revenue	2,396,952					2,396,952
Deferred co-production and set rental revenue	151,647			\$ 170		151,817
Due to affiliates	980,091			20,573	\$(1,000,664)	
Total liabilities	7,113,907			20,743	(1,000,664)	6,133,986
Net assets:						
Unrestricted	(2,797,726)	\$ 1,069,583	\$ (451,668)	60,165		(2,119,646)
Temporarily restricted	7,587,694		5,467,772			13,055,466
Permanently restricted			31,241,960			31,241,960
Total net assets	4,789,968	1,069,583	36,258,064	60,165		42,177,780
TOTAL LIABILITIES AND NET ASSETS	\$11,903,875	\$ 1,069,583	\$36,258,064	\$ 80,908	\$(1,000,664)	\$48,311,766

Houston Grand Opera Association, Inc.

Consolidating Statement of Financial Position as of July 31, 2008

	ASSOCIATION		ENDOWMENT	GUILD	ELIMINATIONS	TOTAL
	OPERATING FUND	PLANT FUND				
ASSETS						
Cash	\$ 400,477		\$ 53,659	\$ 2,320		\$ 456,456
Accounts receivable, net	218,469		3,460			221,929
Pledges receivable, net	9,835,499		1,122,920			10,958,419
Deferred production costs and other assets	1,675,755			78,502		1,754,257
Investments			41,087,418			41,087,418
Property, net		\$ 1,330,565	20			1,330,585
Due from affiliates			1,000,000		\$(1,000,000)	
TOTAL ASSETS	\$12,130,200	\$ 1,330,565	\$43,267,477	\$ 80,822	\$(1,000,000)	\$55,809,064
LIABILITIES AND NET ASSETS						
Liabilities:						
Accounts payable and accrued expenses	\$ 519,040					\$ 519,040
Accrued salaries and benefit costs	276,141					276,141
Co-production payable	84,856					84,856
Note payable	1,500,000					1,500,000
Deferred subscription revenue	2,338,446					2,338,446
Deferred co-production and set rental revenue	419,310					419,310
Due to affiliates	941,446			\$ 58,554	\$(1,000,000)	
Total liabilities	6,079,239			58,554	(1,000,000)	5,137,793
Net assets:						
Unrestricted	(2,453,246)	\$ 1,330,565	\$ (68,486)	22,268		(1,168,899)
Temporarily restricted	8,504,207		12,652,577			21,156,784
Permanently restricted			30,683,386			30,683,386
Total net assets	6,050,961	1,330,565	43,267,477	22,268		50,671,271
TOTAL LIABILITIES AND NET ASSETS	\$12,130,200	\$ 1,330,565	\$43,267,477	\$ 80,822	\$(1,000,000)	\$55,809,064

Houston Grand Opera Association, Inc.

Consolidating Statement of Activities for the year ended July 31, 2009

	ASSOCIATION		ENDOWMENT	GUILD	TOTAL
	OPERATING FUND	PLANT FUND			
REVENUE:					
Contributions	\$11,975,380		\$ 609,366	\$ 17,146	\$12,601,892
Special events	1,615,335			45,196	1,660,531
Cost of direct donor benefits	(629,229)			(23,609)	(652,838)
Ticket sales and performance fees	3,609,028				3,609,028
Co-production and other income	713,354			81,954	795,308
Investment return, net	<u>(15,054)</u>		<u>(4,552,524)</u>		<u>(4,567,578)</u>
Total revenue	<u>17,268,814</u>		<u>(3,943,158)</u>	<u>120,687</u>	<u>13,446,343</u>
EXPENSES:					
Program services	14,652,684	\$ 239,578		5,908	14,898,170
Marketing and advertising	2,722,582	30,118		6,709	2,759,409
Management and general	1,526,451	48,023	800	1,988	1,577,262
Fundraising	<u>2,606,013</u>	<u>29,795</u>		<u>69,185</u>	<u>2,704,993</u>
Total expenses	<u>21,507,730</u>	<u>347,514</u>	<u>800</u>	<u>83,790</u>	<u>21,939,834</u>
Transfers (to) from affiliates	<u>2,977,923</u>	<u>86,532</u>	<u>(3,065,455)</u>	<u>1,000</u>	
CHANGES IN NET ASSETS	(1,260,993)	(260,982)	(7,009,413)	37,897	(8,493,491)
Net assets, beginning of year	<u>6,050,961</u>	<u>1,330,565</u>	<u>43,267,477</u>	<u>22,268</u>	<u>50,671,271</u>
Net assets, end of year	<u>\$ 4,789,968</u>	<u>\$ 1,069,583</u>	<u>\$36,258,064</u>	<u>\$ 60,165</u>	<u>\$42,177,780</u>

Houston Grand Opera Association, Inc.

Consolidating Statement of Activities for the year ended July 31, 2008

	ASSOCIATION		ENDOWMENT	GUILD	TOTAL
	OPERATING FUND	PLANT FUND			
REVENUE:					
Contributions	\$14,467,217		\$ 1,160,137	\$ 970	\$15,628,324
Special events	2,222,639			39,226	2,261,865
Cost of direct donor benefits	(523,841)			(16,972)	(540,813)
Ticket sales and performance fees	4,669,555				4,669,555
Co-production and other income	348,376			125,426	473,802
Investment return, net	<u>(7,684)</u>		<u>(1,949,811)</u>		<u>(1,957,495)</u>
Total revenue	<u>21,176,262</u>		<u>(789,674)</u>	<u>148,650</u>	<u>20,535,238</u>
EXPENSES:					
Program services	13,722,332	\$ 279,645		3,106	14,005,083
Marketing and advertising	2,595,978	14,751		13,695	2,624,424
Management and general	1,711,472	24,815	6,525	7,619	1,750,431
Fundraising	<u>2,559,771</u>	<u>18,934</u>		<u>124,256</u>	<u>2,702,961</u>
Total expenses	<u>20,589,553</u>	<u>338,145</u>	<u>6,525</u>	<u>148,676</u>	<u>21,082,899</u>
Transfers (to) from affiliates	<u>(2,727,918)</u>	<u>(337,090)</u>	<u>2,996,808</u>	<u>68,200</u>	
CHANGES IN NET ASSETS	3,314,627	(1,055)	(3,793,007)	(68,226)	(547,661)
Net assets, beginning of year	<u>2,736,334</u>	<u>1,331,620</u>	<u>47,060,484</u>	<u>90,494</u>	<u>51,218,932</u>
Net assets, end of year	<u>\$ 6,050,961</u>	<u>\$ 1,330,565</u>	<u>\$43,267,477</u>	<u>\$ 22,268</u>	<u>\$50,671,271</u>