

Houston Grand Opera Association, Inc.

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended July 31, 2010 and 2009

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, 2010 and 2009 and the related consolidated statements of activities, of cash flows, and of functional expenses for the years then ended. These consolidated financial statements are the responsibility of the Houston Grand Opera Association, Inc.'s management. Our responsibility is to express an opinion on these consolidated 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, 2010 and 2009 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, 2010 and 2009 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 consolidating 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 19, 2010

Houston Grand Opera Association, Inc.

Consolidated Statements of Financial Position as of July 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash	\$ 663,087	\$ 495,755
Accounts receivable	138,593	147,143
Pledges receivable, net (<i>Note 2</i>)	11,739,910	10,853,022
Deferred production costs and other assets	2,109,588	1,599,456
Beneficial interest in charitable trust, net (<i>Note 3</i>)	2,649,990	
Investments (<i>Notes 4 and 5</i>)	35,423,353	34,146,787
Property, net (<i>Note 6</i>)	<u>994,956</u>	<u>1,069,603</u>
TOTAL ASSETS	<u>\$ 53,719,477</u>	<u>\$ 48,311,766</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 430,758	\$ 553,736
Accrued salaries and benefit costs	122,358	206,569
Co-production payable	38,344	44,912
Note payable (<i>Note 7</i>)	1,465,000	2,780,000
Deferred subscription revenue	2,335,958	2,396,952
Deferred co-production and set rental revenue	<u>219,370</u>	<u>151,817</u>
Total liabilities	<u>4,611,788</u>	<u>6,133,986</u>
Commitments and contingencies (<i>Note 8</i>)		
Net assets:		
Unrestricted	(1,408,949)	(2,119,646)
Temporarily restricted (<i>Note 9</i>)	18,470,726	13,055,466
Permanently restricted (<i>Notes 10 and 11</i>)	<u>32,045,912</u>	<u>31,241,960</u>
Total net assets	<u>49,107,689</u>	<u>42,177,780</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 53,719,477</u>	<u>\$ 48,311,766</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statement of Activities for the year ended July 31, 2010

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Contributions	\$ 7,838,868	\$ 6,183,640	\$ 1,203,952	\$ 15,226,460
Contributions from charitable trust <i>(Note 3)</i>	231,344	2,649,990		2,881,334
Ticket sales and performance fees	3,619,234			3,619,234
Special events	1,737,612	175,200		1,912,812
Cost of direct donor benefits	(655,725)			(655,725)
Co-production and other income	427,800			427,800
Investment return, net <i>(Note 4)</i>	<u>325,869</u>	<u>3,104,617</u>		<u>3,430,486</u>
Total revenue	13,525,002	12,113,447	1,203,952	26,842,401
Net assets released from restrictions:				
Endowment transfer for operations	3,699,200	(3,699,200)		
Expiration of time restrictions	2,437,993	(2,437,993)		
Redesignation for special event	560,994	(560,994)		
Donor-directed redesignation	<u>400,000</u>		<u>(400,000)</u>	
Total	<u>20,623,189</u>	<u>5,415,260</u>	<u>803,952</u>	<u>26,842,401</u>
EXPENSES:				
Program services	13,436,674			13,436,674
Marketing and advertising	2,230,907			2,230,907
Fundraising	2,706,197			2,706,197
Management and general	<u>1,538,714</u>			<u>1,538,714</u>
Total expenses	<u>19,912,492</u>			<u>19,912,492</u>
CHANGES IN NET ASSETS	710,697	5,415,260	803,952	6,929,909
Net assets, beginning of year	<u>(2,119,646)</u>	<u>13,055,466</u>	<u>31,241,960</u>	<u>42,177,780</u>
Net assets, end of year	<u>\$ (1,408,949)</u>	<u>\$ 18,470,726</u>	<u>\$ 32,045,912</u>	<u>\$ 49,107,689</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
Cost of direct donor benefits	(652,838)			(652,838)
Co-production and other income	795,308			795,308
Investment return, net (<i>Note 4</i>)	<u>(397,436)</u>	<u>(4,170,142)</u>	<u> </u>	<u>(4,567,578)</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 Statements of Cash Flows for the years ended July 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 6,929,909	\$ (8,493,491)
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Net realized and unrealized (gain) loss on investments	(2,807,465)	5,153,829
Contributions restricted for endowment	(1,203,952)	(558,574)
Loss on valuation of pledges receivable	501,087	115,998
Amortization of discount on pledges receivable	521,141	(158,646)
Depreciation	203,929	347,513
Changes in operating assets and liabilities:		
Accounts receivable	8,550	74,786
Pledges receivable and beneficial interest in charitable trust	(2,514,498)	87,545
Beneficial interest in charitable trust	(2,649,990)	
Deferred production cost and other assets	(510,132)	154,801
Accounts payable and accrued expenses	(207,189)	(34,876)
Co-production payable	(6,568)	(39,944)
Deferred revenue	<u>6,559</u>	<u>(208,987)</u>
Net cash used by operating activities	<u>(1,728,619)</u>	<u>(3,560,046)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(12,815,866)	(10,655,273)
Proceeds from sale of investments	12,514,496	15,232,272
Net change in cash and money market mutual funds held as investments	1,832,269	(2,790,197)
Purchases of property	<u>(129,282)</u>	<u>(86,531)</u>
Net cash provided by investing activities	<u>1,401,617</u>	<u>1,700,271</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from note payable	8,260,000	7,455,000
Payments on note payable	(9,575,000)	(6,175,000)
Proceeds from contributions restricted for endowment	<u>1,809,334</u>	<u>619,074</u>
Net cash provided by financing activities	<u>494,334</u>	<u>1,899,074</u>
NET CHANGE IN CASH	167,332	39,299
Cash, beginning of year	<u>495,755</u>	<u>456,456</u>
Cash, end of year	<u>\$ 663,087</u>	<u>\$ 495,755</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest paid	\$139,181	\$132,726

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statement of Functional Expenses for the year ended July 31, 2010

	<u>MAINSTAGE</u>	<u>STUDIO</u>	<u>EDUCATION</u>	<u>TOTAL PROGRAM SERVICES</u>	<u>MARKETING AND ADVERTISING</u>	<u>FUNDRAISING</u>	<u>MANAGEMENT AND GENERAL</u>	<u>TOTAL EXPENSES</u>
Salaries and wages	\$ 6,801,916	\$ 534,960	\$ 357,383	\$ 7,694,259	\$ 1,019,275	\$ 1,487,043	\$ 811,840	\$ 11,012,417
Payroll taxes and benefits	1,499,133	172,865	62,125	1,734,123	194,749	224,389	207,038	2,360,299
Professional contractor fees	1,154,387	92,140	91,329	1,337,856	78,467	105,839	98,468	1,620,630
Production materials	1,218,091			1,218,091				1,218,091
Advertising and public relations	338	7,264	17,482	25,084	550,835	187,032	1,664	764,615
Building and storage rentals	558,794	1,688	5,230	565,712	30,471	41,991	17,936	656,110
Office supplies and expenses	87,347	6,822	33,441	127,610	179,432	106,423	73,229	486,694
Travel	134,149	52,878	21,257	208,284	16,136	152,725	100,324	477,469
Insurance	181,422			181,422	15,055	23,053	21,959	241,489
Conferences and meetings		4,460	7,449	11,909	2,315	198,091	2,793	215,108
Depreciation	125,999			125,999	23,753	22,121	32,056	203,929
Bank credit card fees					90,425	55,704	11,965	158,094
Interest							129,956	129,956
Equipment	72,957	4,575	532	78,064	8,780	12,275	14,443	113,562
Royalties	96,314	98	2,210	98,622				98,622
Information technology	12,003			12,003	21,101	22,138	15,043	70,285
Other	17,636			17,636	113	67,373		85,122
Total expenses	<u>\$ 11,960,486</u>	<u>\$ 877,750</u>	<u>\$ 598,438</u>	<u>\$13,436,674</u>	<u>\$ 2,230,907</u>	<u>\$ 2,706,197</u>	<u>\$ 1,538,714</u>	19,912,492
Cost of direct donor benefits								<u>655,725</u>
Total expenditures								<u>\$ 20,568,217</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Consolidated Statement of Functional Expenses for the year ended July 31, 2009

	<u>MAINSTAGE</u>	<u>STUDIO</u>	<u>EDUCATION</u>	<u>TOTAL PROGRAM SERVICES</u>	<u>MARKETING AND ADVERTISING</u>	<u>FUNDRAISING</u>	<u>MANAGEMENT AND GENERAL</u>	<u>TOTAL EXPENSES</u>
Salaries and wages	\$ 6,598,591	\$ 531,368	\$ 415,294	\$ 7,545,253	\$ 1,046,269	\$ 1,508,198	\$ 712,529	\$ 10,812,249
Payroll taxes and benefits	1,560,919	161,547	67,088	1,789,554	217,073	226,615	210,282	2,443,524
Professional contractor fees	1,833,505	74,354	94,973	2,002,832	81,694	19,763	264,858	2,369,147
Production materials	1,732,593		400	1,732,993				1,732,993
Advertising and public relations	4,393	12,764	35,939	53,096	982,897	208,734	2,169	1,246,896
Building and storage rentals	540,280	6,540	10,773	557,593	25,711	31,790	23,516	638,610
Office supplies and expenses	185,036	9,278	31,423	225,737	192,798	103,298	77,782	599,615
Travel	60,744	53,833	23,617	138,194	14,581	180,729	58,822	392,326
Insurance	184,445			184,445	20,465	19,336	19,383	243,629
Conferences and meetings	2,916	6,431	5,706	15,053	7,169	146,056	2,850	171,128
Depreciation	239,578			239,578	30,118	29,795	48,022	347,513
Bank credit card fees					100,794	34,979	11,530	147,303
Interest							132,726	132,726
Equipment	135,297	4,338	1,681	141,316	4,250	199	2,388	148,153
Royalties	168,026		1,410	169,436				169,436
Information technology	57,421			57,421	34,955	32,055	10,405	134,836
Other	45,669			45,669	635	163,446		209,750
Total expenses	<u>\$ 13,349,413</u>	<u>\$ 860,453</u>	<u>\$ 688,304</u>	<u>\$14,898,170</u>	<u>\$ 2,759,409</u>	<u>\$ 2,704,993</u>	<u>\$ 1,577,262</u>	21,939,834
Cost of direct donor benefits								<u>652,838</u>
Total expenditures								<u>\$ 22,592,672</u>

See accompanying notes to consolidated financial statements.

Houston Grand Opera Association, Inc.

Notes to Consolidated Financial Statements for the years ended July 31, 2010 and 2009

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. The Board of Trustees of the Endowment is appointed by the Board of Directors of the Association.

Basis of consolidation – These consolidated financial statements include the consolidated statements of financial position, of activities, of cash flows, and of functional expenses 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.

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 allowance is determined using a combination of historical loss experience and individual account by account analysis of accounts receivable and pledges receivable balances. 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.

Beneficial interest in charitable trust is recorded at the present value of the expected future cash flow payments. Changes in the beneficial interest are recognized as contributions from charitable trust in the statement of activities.

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 are recorded at fair value.

Property is recorded at cost, if purchased, or at fair value at the date of gift, if donated. Property is depreciated using the straight-line method over estimated useful lives of 5 to 15 years. Expenditures greater than \$1,000 with useful lives greater than 22 months are capitalized.

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, a time restriction ends, or Endowment earnings are appropriated for use, 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 support is reported as unrestricted.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Investment return may be used to support donor-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.

Non-cash contributions – Donated materials, use of facilities, and services are recorded at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recognized 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 \$302,140 and \$771,257 in 2010 and 2009, respectively, consisting primarily of travel and professional services, were recognized by the Association.

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 statement of financial position 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.

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 \$228,966 in 2010 and \$641,607 in 2009.

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.

NOTE 2 – PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	<u>2010</u>	<u>2009</u>
Due in less than one year	\$ 7,489,051	\$ 6,159,943
Due in one to five years	4,496,733	4,795,855
Thereafter	<u>25,000</u>	<u>300,000</u>
Total pledges receivable	12,010,784	11,255,798
Discount to present value using 1.62% to 5%	(139,111)	(342,776)
Allowance for uncollectible pledges receivable	<u>(131,763)</u>	<u>(60,000)</u>
Pledges receivable, net	<u>\$ 11,739,910</u>	<u>\$ 10,853,022</u>

During 2008, the Association received a \$5 million conditional pledge, of which \$4 million has been recorded as contributions as of July 31, 2010, as the required benchmarks were satisfied. At July 31, 2010, the conditions had not been met for the remaining \$1 million contribution and this gift is not recorded in these consolidated financial statements. The remaining \$1 million requires the Association to cumulatively raise \$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 – BENEFICIAL INTEREST IN CHARITABLE TRUST

The Association has been named a beneficiary of a charitable trust, which was created in 2010 upon the death of the trust settler for a period of 20 years from the date of death. Each year the trust distributes 8% of the fair value of the trust, as determined for federal estate tax purposes, to the beneficiaries. The Association will receive 30% of that amount each year, or \$182,421 per year through 2029. The change in the beneficial interest in charitable trust during 2010 is as follows:

	<u>2010</u>
Balance at July 31, 2009	\$ 0
Contribution (net of present value discount of \$724,806 at 2.94%)	2,881,334
Payments received from charitable trust	<u>(231,344)</u>
Balance at July 31, 2010	<u>\$ 2,649,990</u>

NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>2010</u>	<u>2009</u>
Fixed-income common collective fund	\$ 8,225,123	\$ 7,822,002
Domestic equity securities	7,771,758	10,232,847
Money market mutual funds	4,193,415	4,625,684
Equity mutual fund	3,586,555	2,592,584
Limited partnership domestic stock fund	2,953,490	3,711,444
Master limited partnerships	2,202,593	
International equity securities	1,847,349	574,153
Fixed-income mutual fund	1,476,815	1,686,458
Commingled international equity fund	1,342,786	1,294,844
Limited partnership real estate fund	1,000,000	
Limited partnership hedge fund	823,469	
Cash awaiting investment		1,400,000
Private energy partnership		<u>206,771</u>
Total investments	<u>\$ 35,423,353</u>	<u>\$ 34,146,787</u>

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 and consists of the following:

	<u>2010</u>	<u>2009</u>
Interest and dividends	\$ 771,322	\$ 734,917
Royalty income	42,619	44,027
Net realized and unrealized gain (loss) on investments	2,807,465	(5,153,829)
Investment fees	<u>(190,920)</u>	<u>(192,693)</u>
Investment return, net	<u>\$ 3,430,486</u>	<u>\$ (4,567,578)</u>

NOTE 5 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. 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. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity's assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at July 31, 2010 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Fixed-income common collective fund		\$ 8,225,123		\$ 8,225,123
Domestic equity securities	\$ 7,771,758			7,771,758
Money market mutual funds	4,193,415			4,193,415
Equity mutual fund	3,586,555			3,586,555
Limited partnership domestic stock fund (a)		2,953,490		2,953,490
Master limited partnerships	2,202,593			2,202,593
International equity securities	1,847,349			1,847,349
Fixed-income mutual fund	1,476,815			1,476,815
Comingled international equity fund (b)		1,342,786		1,342,786
Limited partnership real estate fund (c)			\$ 1,000,000	1,000,000
Limited partnership hedge fund (d)			823,469	823,469
Total assets measured at fair value	<u>\$ 21,078,485</u>	<u>\$ 12,521,399</u>	<u>\$ 1,823,469</u>	<u>\$ 35,423,353</u>

- (a) Redemptions may be made monthly and require 30 days notice.
- (b) Redemptions may be made monthly and require 5 days notice.
- (c) Redemptions may be made on a quarterly basis upon 90 days written notice.
- (d) Redemptions may be made on June 30th of each year upon 90 days notice.

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

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Fixed-income common collective fund			\$ 7,822,002	\$ 7,822,002
Domestic equity securities	\$ 10,232,847			10,232,847
Money market mutual funds	4,625,684			4,625,684
Equity mutual fund	2,592,584			2,592,584
Limited partnership domestic stock fund			3,711,444	3,711,444
International equity securities	574,153			574,153
Fixed-income mutual fund	1,686,458			1,686,458
Comingled international equity fund			1,294,844	1,294,844
Private energy partnership			206,771	206,771
Total assets measured at fair value	<u>\$ 19,711,726</u>	<u>\$ 0</u>	<u>\$ 13,035,061</u>	<u>\$ 32,746,787</u>

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

- *Fixed-income common collective fund, limited partnership domestic stock fund, and commingled international equity fund* are valued at net asset values as determined by the issuer or investment manager based on the fair value of the underlying investments.
- *Equity securities and master limited partnerships* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds* are valued at the published net asset value of shares held at year end.
- *Limited partnership real estate fund* is valued based on the equity method of accounting based on information provided by the general partner. The investment was purchased in July 2010, therefore the purchase price of the investment represents fair value at July 31, 2010.
- *Limited partnership hedge fund* is valued at net asset value as a practical expedient, as determined by the investment manager based on the underlying investments.
- *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.

These valuation methods 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.

Changes in the fair value of Level 3 assets as of July 31, 2010 and 2009 are as follows:

	PRIVATE ENERGY PARTNERSHIP	LIMITED PARTNERSHIP FUNDS	COMMINGLED AND COMMON COLLECTIVE FUNDS	TOTAL
Balance at July 31, 2008	\$ 354,822	\$ 0	\$ 23,890,456	\$ 24,245,278
Net purchases, sales and redemptions	145		(8,218,691)	(8,218,546)
Unrealized loss	(60,767)		(2,779,707)	(2,840,474)
Realized loss	<u>(87,429)</u>		<u>(63,768)</u>	<u>(151,197)</u>
Balance at July 31, 2009	206,771	0	12,828,290	13,035,061
Transfers out of Level 3			(12,828,290)	(12,828,290)
Net purchases, sales and redemptions	(278,022)	1,845,605		1,567,583
Unrealized gain (loss)	53,530	(248,628)		(195,098)
Realized gain	<u>17,721</u>	<u>226,492</u>		<u>244,213</u>
Balance at July 31, 2010	<u>\$ 0</u>	<u>\$ 1,823,469</u>	<u>\$ 0</u>	<u>\$ 1,823,469</u>

The amount reported in changes in net assets for the year ended July 31, 2010 attributable to unrealized losses related to assets held at year end and measured at fair value using significant unobservable inputs is \$248,628. This amount was included in investment return in the accompanying statement of activities for the year ended July 31, 2010.

NOTE 6 – PROPERTY

Property consists of the following:

	<u>2010</u>	<u>2009</u>
Leasehold improvements	\$ 1,907,997	\$ 1,907,997
Office furnishings and equipment	771,141	721,422
Production and music equipment	627,368	561,876
Vehicles	<u>80,352</u>	<u>98,278</u>
Total property, at cost	3,386,858	3,289,573
Accumulated depreciation	<u>(2,391,902)</u>	<u>(2,219,970)</u>
Property, net	<u>\$ 994,956</u>	<u>\$ 1,069,603</u>

NOTE 7 – NOTE PAYABLE

The Association has a \$6 million unsecured line of credit due February 1, 2011, with interest payable monthly at the bank's prime interest rate plus 2% (5.25% at July 31, 2010). Interest expense was \$129,956 in 2010 and \$132,726 in 2009.

NOTE 8 – 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:

2011	\$ 486,310
2012	486,310
2013	478,450
2014	421,179
2015	<u>133,973</u>
Total minimum future lease payments	<u>\$ 2,006,222</u>

Rental expense was approximately \$656,109 in 2010 and \$638,609 in 2009.

Artists' contracts – The Association has 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, 2010, such contracts with artists' call for potential future compensation as follows:

2011	\$ 2,583,000
2012	1,942,000
2013	1,358,500
2014	904,000
2015	423,000
Thereafter	<u>456,000</u>
Total	<u>\$ 7,666,500</u>

NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2010</u>	<u>2009</u>
Restricted for future opera productions	\$ 13,597,537	\$ 7,587,694
Accumulated earnings on permanent endowment:		
General operations	3,929,601	4,435,581
Music director chair	300,878	427,970
Studio	312,624	297,068
New productions	180,955	150,318
Spring Opera Festival	68,422	107,610
Education	76,636	40,784
Wagner opera performances	<u>4,073</u>	<u>8,441</u>
Total temporarily restricted net assets	<u>\$ 18,470,726</u>	<u>\$ 13,055,466</u>

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS

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

	<u>2010</u>	<u>2009</u>
General operating endowment	\$ 21,909,488	\$ 22,105,586
Electronic media	2,130,000	2,130,000
Studio	2,006,534	2,006,484
Concert of Arias	1,352,218	1,352,218
Music director chair	1,300,200	1,300,200
New productions	1,257,473	1,257,473
Fund for Great Artists	1,000,000	
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>\$ 32,045,912</u>	<u>\$ 31,241,960</u>

NOTE 11 – ENDOWMENT

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 the original value of gifts donated to the permanent endowment as permanently restricted net assets. 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, 2008	\$ (68,486)	\$ 12,652,577	\$ 30,683,386	\$ 43,267,477
Contributions		<u>50,792</u>	<u>558,574</u>	<u>609,366</u>
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	<u>(382,382)</u>	<u>(4,170,142)</u>		<u>(4,552,524)</u>
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>
Contributions			<u>1,203,952</u>	<u>1,203,952</u>
Investment return:				
Interest and dividends	90,034	722,543		812,577
Net realized and unrealized gain	249,857	2,554,412		2,804,269
Investment management fees	<u>(18,582)</u>	<u>(172,338)</u>		<u>(190,920)</u>
Net investment return	<u>321,309</u>	<u>3,104,617</u>		<u>3,425,926</u>
Expenses	(17,634)			(17,634)
Donor-directed redesignation	400,000		(400,000)	
Appropriations for expenditure	<u> </u>	<u>(3,699,200)</u>	<u> </u>	<u>(3,699,200)</u>
Endowment net assets, July 31, 2010	<u>\$ 252,007</u>	<u>\$ 4,873,189</u>	<u>\$ 32,045,912</u>	<u>\$ 37,171,108</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 result 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.

Donor-restricted endowment net asset composition as of July 31, 2010:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
General operating	\$ 400,000	\$ 3,929,600	\$ 21,909,488	\$ 26,239,088
Studio		312,624	2,006,534	2,319,158
Electronic media	(80,549)		2,130,000	2,049,451
Music director chair		300,878	1,300,200	1,601,078
New productions		180,955	1,257,473	1,438,428
Concert of Arias	(60,350)		1,352,218	1,291,868
Fund for Great Artists			1,000,000	1,000,000
Education		76,636	634,149	710,785
Spring Opera Festival		68,422	250,000	318,422
New productions with artistic merit	(7,094)		200,000	192,906
Wagner opera performances		4,074	5,850	9,924
Endowment net assets	<u>\$ 252,007</u>	<u>\$ 4,873,189</u>	<u>\$ 32,045,912</u>	<u>\$ 37,171,108</u>

Donor-restricted endowment net asset composition as of July 31, 2009:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY 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		8,439	5,850	14,289
Endowment net assets	<u>\$ (451,668)</u>	<u>\$ 5,467,772</u>	<u>\$ 31,241,960</u>	<u>\$ 36,258,064</u>

NOTE 12 – RETIREMENT PLAN

The Association has a defined contribution retirement plan covering substantially all employees who have completed one year of service. In 2009, the Association matched 100% of the eligible participating employee's contribution up to 2% of the employee's annual salary, this contribution was suspended for fiscal year 2010 and reinstated for fiscal year 2011. The Association contributed approximately \$68,000 to the plan in 2009.

NOTE 13 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 19, 2010, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.

Houston Grand Opera Association, Inc.

Consolidating Statement of Financial Position as of July 31, 2010

	ASSOCIATION		ENDOWMENT	GUILD	ELIMINATIONS	TOTAL
	OPERATING FUND	PLANT FUND				
ASSETS						
Cash	\$ 435,000		\$ 226,587	\$ 1,500		\$ 663,087
Accounts receivable, net	147,502		(8,909)			138,593
Pledges receivable and beneficial interest in charitable trust, net	13,868,359		521,541			14,389,900
Deferred production costs and other assets	2,035,209			74,379		2,109,588
Investments			35,423,353			35,423,353
Property, net		\$ 994,936	20			994,956
Due from affiliates			1,008,516	45,421	\$(1,053,937)	
TOTAL ASSETS	\$16,486,070	\$ 994,936	\$37,171,108	\$ 121,300	\$(1,053,937)	\$53,719,477
LIABILITIES AND NET ASSETS						
Liabilities:						
Accounts payable and accrued expenses	\$ 425,576			\$ 5,182		\$ 430,758
Accrued salaries and benefit costs	122,358					122,358
Co-production payable	38,344					38,344
Note payable	1,465,000					1,465,000
Deferred subscription revenue	2,335,958					2,335,958
Deferred co-production and set rental revenue	219,370					219,370
Due to affiliates	1,053,937				\$(1,053,937)	
Total liabilities	5,660,543			5,182	(1,053,937)	4,611,788
Net assets:						
Unrestricted	(2,772,010)	\$ 994,936	\$ 252,007	116,118		(1,408,949)
Temporarily restricted	13,597,537		4,873,189			18,470,726
Permanently restricted			32,045,912			32,045,912
Total net assets	10,825,527	994,936	37,171,108	116,118		49,107,689
TOTAL LIABILITIES AND NET ASSETS	\$16,486,070	\$ 994,936	\$37,171,108	\$ 121,300	\$(1,053,937)	\$53,719,477

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 and beneficial interest in charitable trust, 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	<u>\$11,903,875</u>	<u>\$ 1,069,583</u>	<u>\$36,258,064</u>	<u>\$ 80,908</u>	<u>\$(1,000,664)</u>	<u>\$48,311,766</u>
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	<u>7,113,907</u>			<u>20,743</u>	<u>(1,000,664)</u>	<u>6,133,986</u>
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	<u>4,789,968</u>	<u>1,069,583</u>	<u>36,258,064</u>	<u>60,165</u>		<u>42,177,780</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$11,903,875</u>	<u>\$ 1,069,583</u>	<u>\$36,258,064</u>	<u>\$ 80,908</u>	<u>\$(1,000,664)</u>	<u>\$48,311,766</u>

Houston Grand Opera Association, Inc.

Consolidating Statement of Activities for the year ended July 31, 2010

	ASSOCIATION		ENDOWMENT	GUILD	TOTAL
	OPERATING FUND	PLANT FUND			
REVENUE:					
Contributions	\$16,859,472		\$ 1,203,952	\$ 44,370	\$18,107,794
Ticket sales and performance fees	3,619,234				3,619,234
Special events	1,846,278			66,534	1,912,812
Cost of direct donor benefits	(624,069)			(31,656)	(655,725)
Co-production and other income	323,812			103,988	427,800
Investment return, net	<u>4,560</u>		<u>3,425,926</u>		<u>3,430,486</u>
Total revenue	<u>22,029,287</u>		<u>4,629,878</u>	<u>183,236</u>	<u>26,842,401</u>
EXPENSES:					
Program services	13,304,685	\$ 125,999		5,990	13,436,674
Marketing and advertising	2,204,219	23,753		2,935	2,230,907
Fundraising	2,597,430	22,121		86,646	2,706,197
Management and general	<u>1,482,736</u>	<u>32,057</u>	<u>17,634</u>	<u>6,287</u>	<u>1,538,714</u>
Total expenses	<u>19,589,070</u>	<u>203,930</u>	<u>17,634</u>	<u>101,858</u>	<u>19,912,492</u>
Transfers (to) from affiliates	<u>3,595,342</u>	<u>129,283</u>	<u>(3,699,200)</u>	<u>(25,425)</u>	
CHANGES IN NET ASSETS	6,035,559	(74,647)	913,044	55,953	6,929,909
Net assets, beginning 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>
Net assets, end of year	<u>\$10,825,527</u>	<u>\$ 994,936</u>	<u>\$37,171,108</u>	<u>\$ 116,118</u>	<u>\$49,107,689</u>

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
Ticket sales and performance fees	3,609,028				3,609,028
Special events	1,615,335			45,196	1,660,531
Cost of direct donor benefits	(629,229)			(23,609)	(652,838)
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
Fundraising	2,606,013	29,795		69,185	2,704,993
Management and general	<u>1,526,451</u>	<u>48,023</u>	<u>800</u>	<u>1,988</u>	<u>1,577,262</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>