

**Houston Symphony Society and
Houston Symphony Endowment**

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended May 31, 2011 and 2010

Independent Auditors' Report

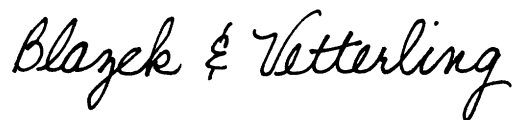
To the Board of Governing Directors of
Houston Symphony Society:

We have audited the accompanying consolidated statements of financial position of Houston Symphony Society and Houston Symphony Endowment (collectively the Symphony) as of May 31, 2011 and 2010 and the related consolidated statements of activities and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the management of the Symphony. 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 financial position of Houston Symphony Society and Houston Symphony Endowment as of May 31, 2011 and 2010 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 basic consolidated financial statements taken as a whole. The supplemental information included on the consolidated statements is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position of the individual companies. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic consolidated financial statements taken as a whole.



September 13, 2011

Houston Symphony Society and Houston Symphony Endowment

Consolidated Statements of Financial Position as of May 31, 2011 and 2010

	2011			2010		
	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
ASSETS						
Cash and cash equivalents	\$ 1,095,580		\$ 1,095,580	\$ 183,771		\$ 183,771
Other receivables	365,457		365,457	318,822		318,822
Prepaid expenses	721,712		721,712	633,002		633,002
Pledges receivable, net (Note 2)	3,215,955	\$ 3,655,803	6,871,758	1,970,293	\$ 5,704,622	7,674,915
Property, net (Note 3)	399,734		399,734	550,111		550,111
Investments (Notes 4 and 5)	<u>308,236</u>	<u>62,672,531</u>	<u>62,980,767</u>	<u>7,915</u>	<u>56,117,870</u>	<u>56,125,785</u>
TOTAL ASSETS	<u>\$ 6,106,674</u>	<u>\$66,328,334</u>	<u>\$72,435,008</u>	<u>\$ 3,663,914</u>	<u>\$61,822,492</u>	<u>\$65,486,406</u>
LIABILITIES AND NET ASSETS						
Liabilities:						
Accounts payable	\$ 600,470		\$ 600,470	\$ 1,016,520		\$ 1,016,520
Accrued expenses	958,450		958,450	846,241		846,241
Deferred revenue	4,092,464		4,092,464	3,816,408		3,816,408
Due to (from) intercompany	3,867,134	\$ (3,867,134)		2,371,010	\$ (2,371,010)	
Note payable (Note 6)	5,288,448		5,288,448	4,606,448		4,606,448
Liability from fair value of interest rate swaps (Notes 5 and 6)	50,806		50,806	4,911		4,911
Accrued pension liability (Note 9)	<u>6,312,965</u>		<u>6,312,965</u>	<u>7,920,691</u>		<u>7,920,691</u>
Total liabilities	<u>21,170,737</u>	<u>(3,867,134)</u>	<u>17,303,603</u>	<u>20,582,229</u>	<u>(2,371,010)</u>	<u>18,211,219</u>
Net assets:						
Unrestricted by donors:						
Orchestra operations	(7,285,453)		(7,285,453)	(7,463,759)		(7,463,759)
Adjustment for pension liability (Note 9)	(9,549,147)		(9,549,147)	(10,775,921)		(10,775,921)
Accumulated endowment losses, net					(892,851)	(892,851)
Total unrestricted net assets	(16,834,600)		(16,834,600)	(18,239,680)	(892,851)	(19,132,531)
Temporarily restricted by donors	1,770,537	4,282,459	6,052,996	1,321,365		1,321,365
Permanently restricted by donors		<u>65,913,009</u>	<u>65,913,009</u>		<u>65,086,353</u>	<u>65,086,353</u>
Total net assets	<u>(15,064,063)</u>	<u>70,195,468</u>	<u>55,131,405</u>	<u>(16,918,315)</u>	<u>64,193,502</u>	<u>47,275,187</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 6,106,674</u>	<u>\$66,328,334</u>	<u>\$72,435,008</u>	<u>\$ 3,663,914</u>	<u>\$61,822,492</u>	<u>\$65,486,406</u>

See accompanying notes to consolidated financial statements.

Houston Symphony Society and Houston Symphony Endowment

Consolidated Statement of Activities for the year ended May 31, 2011

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
OPERATING REVENUE:				
Classical and pops series	\$ 6,141,586			\$ 6,141,586
Other concerts	2,896,232			2,896,232
Other operating income	<u>118,537</u>			<u>118,537</u>
Total operating revenue	<u>9,156,355</u>			<u>9,156,355</u>
OPERATING EXPENSES:				
Orchestra and concert production	17,411,739			17,411,739
Marketing, promotion and ticketing	3,590,636			3,590,636
General and administrative	<u>2,191,934</u>			<u>2,191,934</u>
Total operating expenses	<u>23,194,309</u>			<u>23,194,309</u>
Net deficit before contributed and endowment income	<u>(14,037,954)</u>			<u>(14,037,954)</u>
CONTRIBUTED INCOME:				
Annual fund contributions	9,323,243	\$ 1,630,602		10,953,845
Campaign for a Sound Future contributions			\$ 554,317	554,317
Special events	1,261,100			1,261,100
Less cost of direct donor benefits	(329,057)			(329,057)
Government grants	546,595			546,595
Release of time and purpose restrictions	1,181,430	(1,181,430)		
Loss on valuation of pledges receivable	(74,450)			(74,450)
Fundraising expenses	<u>(1,516,800)</u>			<u>(1,516,800)</u>
Net contributed income	10,392,061	449,172	554,317	11,395,550
Transfer from endowment for operations	<u>3,870,090</u>	<u>(3,870,090)</u>		
Net contributed and endowment income	<u>14,262,151</u>	<u>(3,420,918)</u>	<u>554,317</u>	<u>11,395,550</u>
Change in net assets from operations	224,197	(3,420,918)	554,317	(2,642,404)
OTHER:				
Investment return, net (<i>Note 4</i>)	892,851	8,152,549	272,339	9,317,739
Change in value of interest rate swap agreement	(45,895)			(45,895)
Pension liability adjustment (<i>Note 9</i>)	<u>1,226,778</u>			<u>1,226,778</u>
CHANGES IN NET ASSETS	2,297,931	4,731,631	826,656	7,856,218
Net assets, beginning of year	<u>(19,132,531)</u>	<u>1,321,365</u>	<u>65,086,353</u>	<u>47,275,187</u>
Net assets, end of year	<u>\$ (16,834,600)</u>	<u>\$ 6,052,996</u>	<u>\$ 65,913,009</u>	<u>\$ 55,131,405</u>

See accompanying notes to consolidated financial statements.

Houston Symphony Society and Houston Symphony Endowment

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

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
OPERATING REVENUE:				
Classical and pops series	\$ 6,069,542			\$ 6,069,542
Other concerts	2,958,548			2,958,548
Other operating income	<u>139,308</u>			<u>139,308</u>
Total operating revenue	<u>9,167,398</u>			<u>9,167,398</u>
OPERATING EXPENSES:				
Orchestra and concert production	17,013,738			17,013,738
Marketing, promotion and ticketing	3,735,003			3,735,003
General and administrative	<u>2,313,938</u>			<u>2,313,938</u>
Total operating expenses	<u>23,062,679</u>			<u>23,062,679</u>
Net deficit before contributed and endowment income	<u>(13,895,281)</u>			<u>(13,895,281)</u>
CONTRIBUTED INCOME:				
Annual fund contributions	6,870,374	\$ 771,384		7,641,758
Campaign for a Sound Future contributions			\$ 246,551	246,551
Special events	1,591,122			1,591,122
Less cost of direct donor benefits	(401,187)			(401,187)
Government grants	749,665			749,665
Release of time and purpose restrictions	1,913,205	(1,913,205)		
Loss on valuation of pledges receivable	(166,024)		(53,000)	(219,024)
Fundraising expenses	<u>(1,426,851)</u>			<u>(1,426,851)</u>
Net contributed income	9,130,304	(1,141,821)	193,551	8,182,034
Transfer from endowment for operations	<u>4,103,228</u>	<u>(4,103,228)</u>		
Net contributed and endowment income	<u>13,233,532</u>	<u>(5,245,049)</u>	<u>193,551</u>	<u>8,182,034</u>
Change in net assets from operations	(661,749)	(5,245,049)	193,551	(5,713,247)
OTHER:				
Investment return, net (<i>Note 4</i>)	3,671,729	4,103,228	187,435	7,962,392
Change in value of interest rate swap agreement	58,087			58,087
Pension liability adjustment (<i>Note 9</i>)	<u>945,719</u>			<u>945,719</u>
CHANGES IN NET ASSETS	4,013,786	(1,141,821)	380,986	3,252,951
Net assets, beginning of year	<u>(23,146,317)</u>	<u>2,463,186</u>	<u>64,705,367</u>	<u>44,022,236</u>
Net assets, end of year	<u>\$ (19,132,531)</u>	<u>\$ 1,321,365</u>	<u>\$ 65,086,353</u>	<u>\$ 47,275,187</u>

See accompanying notes to consolidated financial statements.

Houston Symphony Society and Houston Symphony Endowment

Consolidated Statements of Cash Flows for the years ended May 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 7,856,218	\$ 3,252,951
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Net realized and unrealized gain on investments	(8,108,497)	(6,330,270)
Loss on valuation of pledges receivable	74,450	219,024
Change in value of interest rate swap	45,895	(58,087)
Contributions restricted to endowment	(554,317)	(246,551)
Depreciation	166,763	195,175
Changes in operating assets and liabilities:		
Other receivables	(46,635)	(55,364)
Prepaid expenses	(88,710)	320,149
Pledges receivable	(1,320,112)	1,214,445
Accounts payable and accrued expenses	(303,841)	312,124
Deferred revenue	276,056	9,741
Accrued pension liability	<u>(1,607,726)</u>	<u>(478,078)</u>
Net cash used by operating activities	<u>(3,610,456)</u>	<u>(1,644,741)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(18,911,918)	(4,088,751)
Proceeds from sale of investments	21,515,616	7,050,541
Net change in money market mutual funds held for investments	(1,350,183)	(653,740)
Purchases of property	<u>(16,386)</u>	<u>(148,665)</u>
Net cash provided by investing activities	<u>1,237,129</u>	<u>2,159,385</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of note payable	(18,349,000)	(16,125,000)
Proceeds from note payable	19,031,000	14,560,000
Proceeds from contributions restricted to endowment	<u>2,603,136</u>	<u>1,128,682</u>
Net cash provided (used) by financing activities	<u>3,285,136</u>	<u>(436,318)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	911,809	78,326
Cash and cash equivalents, beginning of year	<u>183,771</u>	<u>105,445</u>
Cash and cash equivalents, end of year	<u>\$ 1,095,580</u>	<u>\$ 183,771</u>
<i>Supplemental disclosure of cash flow information:</i>		
Cash paid for interest	\$104,140	\$188,220
Contributed securities	\$1,399,857	\$187,399

See accompanying notes to consolidated financial statements.

Houston Symphony Society and Houston Symphony Endowment

Notes to Consolidated Financial Statements for the years ended May 31, 2011 and 2010

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Houston Symphony Society (the Society) was incorporated under the laws of the State of Texas in 1936 for charitable and educational purposes related to maintaining a symphony orchestra. The mission of the Society is to inspire and enrich the lives of our diverse citizenry through outstanding symphonic music performed by our great orchestra.

Houston Symphony Endowment (the Endowment) was originally established as a trust in 1971 under the laws of the State of Texas as a part of and solely to support the operations of the Society. On June 6, 2006, the form of organization for the Endowment was changed to a separate nonprofit corporation organized under the laws of the State of Texas, to solely support the operations of the Society. The nonprofit exemption was approved by the Internal Revenue Service on May 30, 2007. The Endowment holds contributed funds in perpetuity, invests those funds, and makes contributions from time to time to the Society. Such contributions must meet the stated restrictions of donors as well as the current policies of the Endowment. The Endowment is governed by a Board of Directors who are elected by the officers of the Board of Directors of the Society to serve staggered three-year terms with one-third of the directors elected each year.

Basis of presentation – These financial statements include the consolidated statements of financial position, of activities, and of cash flows for the Society and the Endowment (collectively the Symphony). All balances and transactions between the consolidated entities have been eliminated.

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

Cash equivalents include highly liquid financial instruments with original maturities of three months or less.

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. An allowance for uncollectible pledges is estimated based on management's periodic evaluation of past loss experience, known adverse situations that may affect the donor's ability to pay, and current economic conditions. It is possible that management's estimate regarding the collectability of these balances will change in the near term resulting in a change in the carrying value of the pledges receivable.

Property is reported at cost if purchased and at fair value at the date of gift if donated. Depreciation is provided on a straight-line basis over estimated useful lives of 3 to 10 years.

Investments in marketable securities are reported at fair value. Contributed land held for investment is carried at historical cost based on the fair market value at the date of donation, which is lower than current market 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 as an increase in temporarily or permanently restricted net assets.

Net asset classification – Contributions, investment return 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 restricted by the donor to use 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. At May 31, 2011 and 2010, all temporarily restricted net assets are for future time periods.
- *Permanently restricted net assets* include contributions and investment return that donors have restricted in perpetuity. Investment return that has not been restricted in perpetuity may be used to support the operations of the Symphony.

Revenue from ticket sales is recognized when the related services are provided. Amounts received but unearned are included in the statement of financial position as deferred revenue. Program costs are deferred when incurred and charged to expense when the related revenue is recognized.

Contributions – Contributions, including government grants, are recognized as revenue at fair value when an unconditional commitment is received from the donor. Generally, contributions received with donor restrictions that limit their use are recorded as temporarily or permanently restricted contributions. Restricted contributions whose purpose is met in the same reporting period are reported as unrestricted contributions and increase unrestricted net assets. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Donated materials, use of facilities and services – Donated materials and use of facilities are recognized at fair value as unrestricted 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. A substantial number of volunteers have contributed significant amounts of time in connection with programs, administration and fundraising for which no amount has been recorded in the financial statements because the services do not meet the criteria for recognition under generally accepted accounting principles.

Advertising costs are expensed as incurred except for expenditures related to future seasons which are recorded as prepaid expenses. In 2011 and 2010, the Symphony expensed approximately \$843,000 and \$862,000, respectively, for advertising costs. At May 31, 2011 and 2010, prepaid expenses include deferred advertising costs of approximately \$47,000 and \$76,000, respectively.

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

In 2007, the Symphony launched a \$75 million capital campaign, entitled *My Houston, My Symphony: Campaign for a Sound Future*, to address two critical financial goals: adding \$60 million to the Symphony’s endowment, and raising an additional \$15 million in working capital for operations.

Pledges receivable at May 31, 2011 consist of the following:

	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
Pledges receivable are expected to be collected as follows:			
Less than one year	\$ 3,016,571	\$ 2,931,785	\$ 5,948,356
One to five years	<u>300,000</u>	<u>768,000</u>	<u>1,068,000</u>
Total pledges receivable	3,316,571	3,699,785	7,016,356
Unamortized discount (at interest rates from .19% to 2.05%)	(616)	(25,982)	(26,598)
Allowance for uncollectible pledges receivable	<u>(100,000)</u>	<u>(18,000)</u>	<u>(118,000)</u>
Pledges receivable, net	<u>\$ 3,215,955</u>	<u>\$ 3,655,803</u>	<u>\$ 6,871,758</u>

Pledges receivable at May 31, 2010 consist of the following:

	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
Total pledges receivable	\$ 2,046,398	\$ 5,757,500	\$ 7,803,898
Unamortized discount	(1,105)	(32,878)	(33,983)
Allowance for uncollectible pledges receivable	<u>(75,000)</u>	<u>(20,000)</u>	<u>(95,000)</u>
Pledges receivable, net	<u>\$ 1,970,293</u>	<u>\$ 5,704,622</u>	<u>\$ 7,674,915</u>

The Society received a conditional pledge from a local foundation of \$9,000,000 in February 2005. The pledge was receivable at \$2,250,000 each year from 2006 to 2009 conditional upon the Symphony raising matching funds of \$18,000,000 during the period of February 2005 through February 2009. The terms of the gift have been extended to February 2012. This grant and matching contributions are permanently restricted. The matching funds raised must be specifically designated by the donors as funds to match this grant. The Symphony recognizes this contribution as the matching requirements are substantially met. As of May 31, 2011, \$6,750,000 has been recognized and \$2,250,000 remains conditional upon raising the required matching funds.

The Society received a \$2,000,000 conditional pledge from another local foundation in May 2010. The grant is payable in fiscal year 2012 and 2013 if the Society meets specified conditions and will be recognized as the conditions are substantially met.

NOTE 3 – PROPERTY

Property consists of the following:

	<u>2011</u>	<u>2010</u>
Land	\$ 16,915	\$ 16,915
Computer and information systems	1,096,972	1,096,972
Instruments	865,342	848,956
Leasehold improvements	219,244	219,244
Furniture and equipment	<u>98,408</u>	<u>98,408</u>
Total property, at cost	2,296,881	2,280,495
Accumulated depreciation	<u>(1,897,147)</u>	<u>(1,730,384)</u>
Property, net	<u>\$ 399,734</u>	<u>\$ 550,111</u>

NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>Liquidity</u>	<u>Redemption Notice</u>	<u>2011</u>	<u>2010</u>
TIFF Multi-Asset Mutual Fund (a)	Daily	None	\$ 40,200,042	\$ 33,925,251
Large-Cap Stock Index Fund	Daily	None	3,870,991	86,017
Equity securities (service and energy)	Daily	None	308,236	7,915
Hedge funds and funds of funds:				
The Endowment Fund (b)	Quarterly	40 days	13,182,175	2,059,715
Common Fund:				
Global Absolute Alpha (c)	Semi annual	95 days	996,393	928,682
Global Hedge Fund (d)	Annually (on December 31)	90 days	985,574	902,555
Hedged Investors Fund (e)	Quarterly	90 days	767,516	705,939
Equity Fund	Monthly	5 days		10,278,915
Bond Fund	Monthly	5 days		5,095,804
Commodities Fund	Monthly	30 days		815,335
Money market mutual funds			2,189,840	839,657
Land held for investment			<u>480,000</u>	<u>480,000</u>
Total investments			<u>\$ 62,980,767</u>	<u>\$ 56,125,785</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.

Hedge funds and funds of funds as well as the TIFF Multi-Asset Mutual Fund are invested with external investment managers who can invest in various alternative categories, including real estate, partnerships, long and short equity positions, natural resources, private equity, managed futures, emerging markets, distressed enterprises, and arbitrage positions. These investments are domestic and international in nature, may be illiquid, and may not be realized for a period of several years after the investments are made. In addition to risks associated with other investments, the investments include additional risks, resulting in a greater risk of losing invested capital. Such risks include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition. The investment strategies of each of these funds are as follows:

- (a) The fund seeks to achieve a total return that, over a majority of market cycles, exceeds inflation plus 5% per annum by employing a globally diversified portfolio. Such diversification is designed to constitute a hedge against catastrophic losses during times when the fund's total return segment may be misfiring. The fund generally maintains its desired alignment of exposures by deploying equity futures, currency futures, U. S. Treasury futures, and swaps as needed.

- (b) The fund seeks to preserve capital and to generate consistent long-term appreciation across a market cycle of five to seven years. This is a fund of funds with the underlying master fund investing in a variety of investment vehicles including but not limited to limited partnerships, limited liability companies, offshore corporations and other foreign investment vehicles, registered investment companies (including exchange-traded funds) and direct investments in marketable securities and derivative instruments.
- (c) The fund seeks to provide a marketable alternative strategies investment program capable of producing consistently positive returns regardless of the direction of the broader markets. The long-term return objective is to outperform 3-month U. S. Treasury bills by more than 400 basis points annually, net of fees and expenses. The goal of the fund is to offer access to a moderate volatility investment program with little or no net market exposure, yielding consistent returns independent of market directions. The fund allocates assets to funds in four broad investment categories: event-driven, fixed income arbitrage, equity market neutral and absolute return multi-strategy managers.
- (d) The fund seeks to provide net returns over a full market cycle in excess of its benchmark of the London Interbank Offered Rate (LIBOR) plus 500 basis points and to maintain significant regional diversification. Investments are selected with the goal of providing investment exposure across Europe, Asia and North America, as well as emerging markets. The fund invests primarily in offshore investment funds, investment partnerships, and pooled investment vehicles.
- (e) The fund seeks to provide an investment program that is capable of outperforming the S&P 500 Index over a full market cycle, while providing some protection during down markets. This is a fund of funds made up of investment in the three following master funds: Commonfund Hedged Equity Company, Commonfund Global Macro Company, and Commonfund Diversifying Hedged Strategies Company.

Investment return consists of the following:

	<u>2011</u>	<u>2010</u>
Interest and dividends	\$ 1,169,218	\$ 1,650,632
Net realized and unrealized gain	8,108,497	6,330,270
Rents	60,000	60,000
Royalties	53,410	44,757
Investment fees	<u>(73,386)</u>	<u>(123,267)</u>
Investment return, net	<u>\$ 9,317,739</u>	<u>\$ 7,962,392</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 market 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 May 31, 2011 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
TIFF Multi-Asset Mutual Fund			\$ 40,200,042	\$ 40,200,042
Hedge funds and funds of funds			15,931,658	15,931,658
Index fund	\$ 3,870,991			3,870,991
Money market mutual funds	2,189,840			2,189,840
Equity securities	<u>308,236</u>			<u>308,236</u>
Total assets measured at fair value	<u>\$ 6,369,067</u>	<u>\$ 0</u>	<u>\$ 56,131,700</u>	<u>\$ 62,500,767</u>

Liabilities measured at fair value as of May 31, 2011 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Interest rate swaps	<u>\$ 0</u>	<u>\$ (50,806)</u>	<u>\$ 0</u>	<u>\$ (50,806)</u>

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

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
TIFF Multi-Asset Mutual Fund			\$ 33,925,251	\$ 33,925,251
Hedge funds and funds of funds			20,786,945	20,786,945
Index fund	\$ 86,017			86,017
Money market mutual funds	839,657			839,657
Equity securities	<u>7,915</u>			<u>7,915</u>
Total assets measured at fair value	<u>\$ 933,589</u>	<u>\$ 0</u>	<u>\$ 54,712,196</u>	<u>\$ 55,645,785</u>

Liabilities measured at fair value as of May 31, 2010 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Interest rate swap	<u>\$ 0</u>	<u>\$ (4,911)</u>	<u>\$ 0</u>	<u>\$ (4,911)</u>

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

- *Level 3 mutual funds and hedge funds and funds of funds* are valued at the net asset value per share as determined by the issuer and the values reported in the audited financial statements as a practical expedient because these investments do not have a readily determinable fair value.
- *Index fund and equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Money market mutual funds* are valued at the reported net asset value.
- *Interest rate swap* is valued based upon market interest rates and the expected cash flows of the swap based on Eurodollar futures.

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 Symphony 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 consist of the following:

Balance at May 31, 2009	\$ 49,796,546
Net realized and unrealized gain	6,311,016
Purchases, sales, issuances and settlements, net	<u>(1,395,366)</u>
Balance at May 31, 2010	54,712,196
Net realized and unrealized gain	7,867,556
Purchases, sales, issuances and settlements, net	<u>(6,448,052)</u>
Balance at May 31, 2011	<u>\$ 56,131,700</u>

NOTE 6 – NOTE PAYABLE

Note payable represents the outstanding balance on an \$8,500,000 unsecured line of credit that expires November 20, 2013. Interest is payable quarterly at a variable rate equal to 1.30% over LIBOR (1.607% at May 31, 2011). Under the terms of the note, the Symphony is required to maintain a tangible net worth of \$40 million and its ratio of liabilities to tangible net worth cannot exceed 75%.

To reduce its exposure to interest rate volatility, the Symphony entered into two interest rate swap agreements with the financing institution effective January 1, 2011. The first agreement has a notional amount of \$4 million with a fixed rate of 2.39% through March 30, 2013. The second agreement has a notional amount of \$2.0 million with a fixed rate of 2.20% through March 30, 2012. Interest is payable quarterly. In the event the Symphony terminates these interest rate swap agreements prior to maturity, early termination fees will be incurred.

NOTE 7 – OPERATING LEASE COMMITMENTS

The Symphony leases certain of its facilities under noncancelable operating lease agreements. Future minimum lease payments under these operating leases as of May 31, 2011 are as follows:

2012	\$ 171,928
2013	74,313
2014	58,108
2015	<u>58,018</u>
Total	<u>\$ 362,367</u>

Rent expense for 2011 and 2010 was \$593,552 and \$610,997, respectively.

NOTE 8 – ENDOWMENT

The Endowment was established for the purpose of supporting the Society. It includes only donor-restricted endowment funds. The Endowment Board of Directors 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 Symphony classifies the original value of gifts donated to the permanent endowment and investment return restricted by the donor in perpetuity as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Endowment Board of Directors 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 accumulated donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Symphony 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 Symphony
- The investment policies of the Endowment

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

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Endowment net assets, June 1, 2009	\$ (4,564,580)	\$ 0	\$ 64,705,367	\$ 60,140,787
Contributions			<u>193,551</u>	<u>193,551</u>
Investment return:				
Interest and dividends	1,755,389			1,755,389
Net realized and unrealized gain	2,039,607	4,103,228	187,435	6,330,270
Investment management fees	<u>(123,267)</u>			<u>(123,267)</u>
Net investment return	<u>3,671,729</u>	<u>4,103,228</u>	<u>187,435</u>	<u>7,962,392</u>
Distributions		<u>(4,103,228)</u>		<u>(4,103,228)</u>
Endowment net assets, May 31, 2010	<u>(892,851)</u>	<u>0</u>	<u>65,086,353</u>	<u>64,193,502</u>
Contributions			<u>554,317</u>	<u>554,317</u>
Investment return:				
Interest, dividends, rents and royalties	892,851	389,777		1,282,628
Net realized and unrealized gain		7,836,158	272,339	8,108,497
Investment management fees		<u>(73,386)</u>		<u>(73,386)</u>
Net investment return	<u>892,851</u>	<u>8,152,549</u>	<u>272,339</u>	<u>9,317,739</u>
Distributions		<u>(3,870,090)</u>		<u>(3,870,090)</u>
Endowment net assets, May 31, 2011	<u>\$ 0</u>	<u>\$ 4,282,459</u>	<u>\$ 65,913,009</u>	<u>\$ 70,195,468</u>

Funds with Deficiencies

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 Symphony to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are reported in unrestricted net assets.

Return Objectives and Risk Parameters

The Endowment has adopted investment and spending policies for endowment assets that have the primary objective of achieving a long-term rate-of-return that will permit the Endowment to assist the Symphony in meeting its operating needs while maintaining its ability to provide for future needs without subjecting the endowment funds to imprudent risks. Endowment assets include those assets of donor-restricted funds that the Symphony must hold in perpetuity or for the donor-specified periods.

Strategies Employed for Achieving Objectives

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 a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

As different asset classes produce different returns during the course of the year, the portfolio's asset allocation changes accordingly. Therefore, rebalancing asset allocations to policy targets is essential for maintaining the risk and return profile that has been adopted. The Endowment reviews the portfolio's actual asset allocation, relative to established policy target and ranges. If deemed necessary, the Endowment will rebalance the portfolio between the various asset classes based on market values.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Endowment's standing resolution on disbursements has a total return spending rule that allows spending budgets to be funded from interest and dividend income, realized gains, unused portions of prior year spending allowances that have been reinvested, and unrealized appreciation (to use "unrealized appreciation," units would have to be sold). Under the standing resolution, annual expenditures are determined annually based on the Endowment's twelve quarter rolling average as of the March 31 proceeding the Symphony's fiscal year in which the disbursement will be expended. Subject to restrictions placed by either donors or governing law, disbursements are at the discretion of the Endowment directors and may be increased or decreased at any time, and the standing policy may be suspended or altered at any time.

NOTE 9 – PENSION PLAN

Defined Benefit Retirement Plans – The Symphony has two pension plans, the Musicians Retirement Plan and the Staff Employees Retirement Plan (collectively the Plans) covering substantially all of its employees. Retirement benefits primarily are a function of a fixed amount reduced pro-rata for services less than 30 years under the Musicians Retirement Plan and the employee's compensation and years of service under the Staff Employees Retirement Plan. The Symphony's policy is to currently fund accrued pension costs. In 1998, the Symphony agreed to freeze the Musicians Retirement Plan and to begin funding the musicians retirement through the American Federation of Musicians and Employers' Pension Plan (AFM) fund, a multi-employer plan. The Symphony uses a May 31 valuation date.

The funded status of each plan at May 31, 2011 and 2010 is as follows:

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Projected benefit obligation	\$ 15,782,479	\$ 4,160,129	\$ 15,252,987	\$ 3,885,417
Fair value of plan assets	<u>(10,846,266)</u>	<u>(2,783,377)</u>	<u>(9,017,610)</u>	<u>(2,200,103)</u>
Unfunded projected benefit obligation	<u>\$ 4,936,213</u>	<u>\$ 1,376,752</u>	<u>\$ 6,235,377</u>	<u>\$ 1,685,314</u>
Accumulated benefit obligation	<u>\$ 15,782,479</u>	<u>\$ 3,959,143</u>	<u>\$ 15,252,987</u>	<u>\$ 3,629,673</u>

Amounts recognized in the statement of financial position at May 31, 2011 and 2010 are as follows:

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Accrued pension liability	<u>\$ 4,936,213</u>	<u>\$ 1,376,752</u>	<u>\$ 6,235,377</u>	<u>\$ 1,685,314</u>

Amounts recognized in unrestricted net assets, not yet recognized as periodic pension cost at May 31, 2011 and 2010 are as follows:

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Net loss	\$ 8,313,781	\$ 1,314,835	\$ 9,247,225	\$ 1,583,978
Prior service cost	<u>22,473</u>	<u> </u>	<u>46,660</u>	<u> </u>
Total	<u>\$ 8,336,254</u>	<u>\$ 1,314,835</u>	<u>\$ 9,293,885</u>	<u>\$ 1,583,978</u>

Components of net periodic benefit cost at May 31, 2011 and 2010 are as follows:

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Interest cost	\$ 827,025	\$ 210,234	\$ 58,433	\$ 199,691
Service cost		136,975		165,950
Expected return on assets	(822,561)	(213,349)	(750,943)	(166,587)
Amortization of prior service cost	24,187		24,187	
Amortization of loss	<u>770,118</u>	<u>132,781</u>	<u>799,463</u>	<u>198,068</u>
Total net periodic benefit cost	<u>\$ 798,769</u>	<u>\$ 266,641</u>	<u>\$ 131,140</u>	<u>\$ 397,122</u>

Other changes in plan assets and benefit obligations recognized in changes in net assets are as follows:

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Net loss (gain)	\$ (307,612)	\$ (171,564)	\$ (164,121)	\$ 84,422
Amortization of prior service cost	(24,187)		(24,187)	
Amortization of net gain	<u>(625,836)</u>	<u>(97,579)</u>	<u>(671,330)</u>	<u>(170,503)</u>
Total recognized in changes in net assets	<u>\$ (957,635)</u>	<u>\$ (269,143)</u>	<u>\$ (859,638)</u>	<u>\$ (86,081)</u>

The estimated actuarial gain from the pension plan that will be amortized into net periodic benefit cost over the next fiscal year are \$175,000 for the Staff Employees Retirement Plan and \$815,500 for the Musicians Retirement Plan. There is no estimated transition asset or prior service credit from the Staff Employees Retirement Plan or Musicians Retirement Plan that will be amortized over the next fiscal year.

	MUSICIANS PLAN 2011	STAFF PLAN 2011	MUSICIANS PLAN 2010	STAFF PLAN 2010
Discount rate	5.50%	5.50%	5.75%	5.75%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%

Weighted-average assumptions used to determine net periodic cost:

Discount rate	5.75%	5.75%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Average future working lifetime	7.91	5.04	8.86	5.33

The expected long-term rate-of-return on assets is established taking into account the intended asset mix and historical rates of return on comparable assets.

Plan assets

The Plans were established for the exclusive purpose of providing benefits for employees and beneficiaries. Consistent with this purpose, the primary goal of managing the portfolio assets is to invest the assets so as to preserve the capital and provide an acceptable rate of growth and income. The Plans shall seek the highest possible return while maintaining a prudent regard for legal considerations, fiduciary responsibility, safety of capital and minimum volatility of returns.

The Symphony's targeted pension plan asset allocation by type of asset is as follows:

Equity	50%-75%
Fixed income	20%-50%
Cash and other	0%-20%

Plan assets measured at fair value on a recurring basis for the Plans at May 31, 2011, by asset category are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Equity mutual funds	\$ 7,816,937			\$ 7,816,937
Fixed income mutual funds	3,388,689			3,388,689
Other funds			\$ 2,424,017	2,424,017
Total	<u>\$ 11,205,626</u>	<u>\$ 0</u>	<u>\$ 2,424,017</u>	<u>\$ 13,629,643</u>

Plan assets measured at fair value on a recurring basis for the Plans at May 31, 2010, by asset category are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Equity mutual funds	\$ 5,776,555			\$ 5,776,555
Fixed income mutual funds	3,142,081			3,142,081
Other funds			\$ 2,299,077	2,299,077
Total	<u>\$ 8,918,636</u>	<u>\$ 0</u>	<u>\$ 2,299,077</u>	<u>\$ 11,217,713</u>

Investments in mutual funds are valued based on published net asset values. Investments in other funds are valued using the net asset value per share as determined by the issuer and the values are reported in the audited financial statements.

Changes in the fair value of Level 3 assets consist of the following:

	<u>TOTAL</u>
Balance at May 31, 2009	\$ 1,622,844
Net sales and purchases	555,000
Net unrealized gain	<u>121,233</u>
Balance at May 31, 2010	2,299,077
Net unrealized gain	<u>124,940</u>
Balance at May 31, 2011	<u>\$ 2,424,017</u>

No assets of the Plans are expected to be returned to the Symphony in the next fiscal year.

Cash flows

Contributions to the Plans provide for benefits attributed to service to date, as well as those expected to be earned in the future. The Symphony's contributions to the Plans totaled \$1,446,362 in 2011 and \$1,328,262 in 2010. The Symphony expects to contribute approximately \$1,586,000 to the plan in 2012. Additionally, the Symphony paid to AFM on behalf of the musicians, a total of \$419,382 in 2011 and \$400,454 in 2010. Distributions from the Plans during 2011 and 2010 were \$1,055,993 and \$1,189,111, respectively.

Estimated future benefit payments for next ten years are as follows:

	<u>MUSICIANS PLAN</u>	<u>STAFF PLAN</u>
2012	\$ 1,070,239	\$ 135,341
2013	1,075,190	163,240
2014	1,099,498	181,676
2015	1,081,526	209,666
2016	1,062,735	224,121
2017 through 2021	<u>5,624,106</u>	<u>1,293,703</u>
Total	<u>\$ 11,013,294</u>	<u>\$ 2,207,747</u>

NOTE 10 – CONCENTRATION OF RISK

All of the Symphony's musician employees who perform in the Houston Symphony Orchestra are parties to a collective bargaining agreement with the Symphony. In September 2010, a new agreement was reached that expires in October 2014.

NOTE 11 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 13, 2011, 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.
