

**Houston Symphony Society and
Houston Symphony Endowment**

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

Independent Auditors' Report

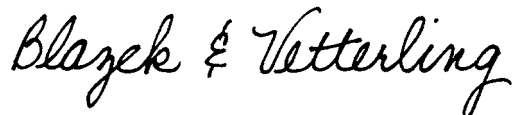
To the Board of Governing Directors of
Houston Symphony Society:

We have audited the accompanying consolidated statements of financial position of Houston Symphony Society and Houston Symphony Endowment (collectively referred to as the Symphony) as of May 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 management of the Symphony. 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 financial position of Houston Symphony Society and Houston Symphony Endowment as of May 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 made for the purpose of forming an opinion on the consolidated financial statements of Houston Symphony Society and Houston Symphony Endowment taken as a whole. The supplemental information included on the consolidated statements of financial position for Houston Symphony Society and Houston Symphony Endowment is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position of the individual companies. This information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly presented in all material respects in relation to the consolidated financial statements taken as a whole.



October 2, 2009

Houston Symphony Society and Houston Symphony Endowment

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

	2009			2008		
	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
ASSETS						
Cash and cash equivalents	\$ 105,445		\$ 105,445	\$ 240,273		\$ 240,273
Other receivables	263,458		263,458	220,556		220,556
Prepaid expenses	953,151		953,151	990,224		990,224
Pledges receivable, net (<i>Note 2</i>)	3,370,762	\$ 6,619,753	9,990,515	4,923,953	\$ 8,480,735	13,404,688
Property, net (<i>Note 3</i>)	596,621		596,621	696,302		696,302
Investments (<i>Note 4 and 5</i>)	251	52,103,314	52,103,565	10,196	67,085,162	67,095,358
TOTAL ASSETS	\$ 5,289,688	\$58,723,067	\$64,012,755	\$ 7,081,504	\$75,565,897	\$82,647,401
LIABILITIES AND NET ASSETS						
Liabilities:						
Accounts payable	\$ 843,654		\$ 843,654	\$ 1,060,575		\$ 1,060,575
Accrued expenses	706,983		706,983	628,930		628,930
Deferred revenue	3,806,667		3,806,667	4,089,781		4,089,781
Due to (from) intercompany	1,417,720	\$(1,417,720)		1,783,253	\$(1,783,253)	
Note payable (<i>Note 6</i>)	6,171,448		6,171,448	4,952,448		4,952,448
Liability from fair value of interest rate swap (<i>Note 5 and 6</i>)	62,998		62,998			
Accrued pension liability (<i>Note 9</i>)	8,398,769		8,398,769	3,645,942		3,645,942
Total liabilities	21,408,239	(1,417,720)	19,990,519	16,160,929	(1,783,253)	14,377,676
Net assets:						
Unrestricted by donors:						
Orchestra operations	(6,860,097)		(6,860,097)	(5,808,970)		(5,808,970)
Adjustment for pension liability (<i>Note 9</i>)	(11,721,640)		(11,721,640)	(6,883,008)		(6,883,008)
Accumulated endowment losses, net		(4,564,580)	(4,564,580)			
Total unrestricted net assets	(18,581,737)	(4,564,580)	(23,146,317)	(12,691,978)		(12,691,978)
Temporarily restricted by donors	2,463,186		2,463,186	3,612,553	12,496,473	16,109,026
Permanently restricted by donors		64,705,367	64,705,367		64,852,677	64,852,677
Total net assets	(16,118,551)	60,140,787	44,022,236	(9,079,425)	77,349,150	68,269,725
TOTAL LIABILITIES AND NET ASSETS	\$ 5,289,688	\$58,723,067	\$64,012,755	\$ 7,081,504	\$75,565,897	\$82,647,401

See accompanying notes to consolidated financial statements.

Houston Symphony Society and Houston Symphony Endowment

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

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
OPERATING REVENUE:				
Classical and pops series	\$ 6,475,500			\$ 6,475,500
Other concerts	2,245,671			2,245,671
Other operating income	<u>227,113</u>			<u>227,113</u>
Total operating revenue	<u>8,948,284</u>			<u>8,948,284</u>
OPERATING EXPENSES:				
Orchestra and concert production	16,375,706			16,375,706
Marketing, promotion and ticketing	3,284,172			3,284,172
General and administrative	<u>2,219,152</u>			<u>2,219,152</u>
Total operating expenses	<u>21,879,030</u>			<u>21,879,030</u>
Net deficit before contributed and endowment income	<u>(12,930,746)</u>			<u>(12,930,746)</u>
CONTRIBUTED INCOME:				
Annual fund contributions	4,683,576	\$ 1,312,713		5,996,289
Campaign for a Sound Future contributions	207,000		\$ 323,545	530,545
Special events	1,707,689			1,707,689
Less cost of direct donor benefits	(391,195)			(391,195)
Government grants	706,936			706,936
Release of time and purpose restrictions	2,462,080	(2,462,080)		
Loss on valuation of pledges receivable	(125,850)		(63,859)	(189,709)
Fundraising expenses	<u>(1,671,962)</u>			<u>(1,671,962)</u>
Net contributed income	7,578,274	(1,149,367)	259,686	6,688,593
Transfer from endowment for operations	<u>4,364,343</u>	<u>(4,364,343)</u>		
Net contributed and endowment income	<u>11,942,617</u>	<u>(5,513,710)</u>	<u>259,686</u>	<u>6,688,593</u>
Change in net assets from operations	(988,129)	(5,513,710)	259,686	(6,242,153)
OTHER:				
Investment return, net (<i>Note 4</i>)	(4,564,580)	(8,132,130)	(406,996)	(13,103,706)
Change in value of interest rate swap agreement	(62,998)			(62,998)
Pension liability adjustment	<u>(4,838,632)</u>			<u>(4,838,632)</u>
CHANGES IN NET ASSETS	(10,454,339)	(13,645,840)	(147,310)	(24,247,489)
Net assets, beginning of year	<u>(12,691,978)</u>	<u>16,109,026</u>	<u>64,852,677</u>	<u>68,269,725</u>
Net assets, end of year	<u>\$ (23,146,317)</u>	<u>\$ 2,463,186</u>	<u>\$ 64,705,367</u>	<u>\$ 44,022,236</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, 2008

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
OPERATING REVENUE:				
Classical and pops series	\$ 6,445,006			\$ 6,445,006
Other concerts	2,091,640			2,091,640
Other operating income	<u>188,558</u>			<u>188,558</u>
Total operating revenue	<u>8,725,204</u>			<u>8,725,204</u>
OPERATING EXPENSES:				
Orchestra and concert production	16,049,267			16,049,267
Marketing, promotion and ticketing	3,568,105			3,568,105
General and administrative	<u>2,109,314</u>			<u>2,109,314</u>
Total operating expenses	<u>21,726,686</u>			<u>21,726,686</u>
Net deficit before contributed and endowment income	<u>(13,001,482)</u>			<u>(13,001,482)</u>
CONTRIBUTED INCOME:				
Annual fund contributions	5,028,578	\$ 2,031,048		7,059,626
Campaign for a Sound Future contributions	452,763	516,142	\$ 5,404,993	6,373,898
Special events	1,794,979			1,794,979
Less cost of direct donor benefits	(400,170)			(400,170)
Government grants	691,635			691,635
Release of time and purpose restrictions	3,365,584	(3,365,584)		
Loss on valuation of pledges receivable	(56,093)			(56,093)
Fundraising expenses	<u>(1,704,665)</u>			<u>(1,704,665)</u>
Net contributed income	9,172,611	(818,394)	5,404,993	13,759,210
Transfer from board designated endowment	<u>3,881,020</u>			<u>3,881,020</u>
Net contributed and endowment income	<u>13,053,631</u>	<u>(818,394)</u>	<u>5,404,993</u>	<u>17,640,230</u>
Change in net assets from operations	52,149	(818,394)	5,404,993	4,638,748
OTHER:				
Investment return, net (<i>Note 4</i>)		2,670,804	22,826	2,693,630
Transfer to operations		(3,881,020)		(3,881,020)
Minimum pension liability adjustment	<u>(1,107,321)</u>			<u>(1,107,321)</u>
CHANGES IN NET ASSETS	(1,055,172)	(2,028,610)	5,427,819	2,344,037
Reclassification of net assets (<i>Note 8</i>)	(13,706,687)	13,706,687		
Net assets, beginning of year	<u>2,069,881</u>	<u>4,430,949</u>	<u>59,424,858</u>	<u>65,925,688</u>
Net assets, end of year	<u>\$ (12,691,978)</u>	<u>\$ 16,109,026</u>	<u>\$ 64,852,677</u>	<u>\$ 68,269,725</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, 2009 and 2008

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ (24,247,489)	\$ 2,344,037
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Depreciation	180,574	164,520
Net realized and unrealized (gain) loss on investments	14,578,102	(561,812)
Loss on valuation of pledges receivable	189,709	56,093
Change in value of interest rate swap	62,998	
Contributions restricted to endowment	(323,545)	(5,404,993)
Changes in operating assets and liabilities:		
Other receivables	(42,902)	(50,791)
Prepaid expenses	37,073	5,424
Pledges receivable	1,427,341	2,486,441
Intangible pension asset		171,124
Accounts payable and accrued expenses	(138,868)	(180,196)
Deferred revenue	(283,114)	291,592
Accrued pension liability	<u>4,752,827</u>	<u>82,668</u>
Net cash used by operating activities	<u>(3,807,294)</u>	<u>(595,893)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property	(80,893)	(131,908)
Purchases of investments	(3,222,126)	(14,093,738)
Proceeds from sale of investments	3,561,402	11,285,818
Net change in cash and cash equivalents held for investment	<u>74,415</u>	<u>794,442</u>
Net cash provided (used) by investing activities	<u>332,798</u>	<u>(2,145,386)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of note payable	(13,761,000)	(18,610,000)
Proceeds from note payable	14,980,000	17,024,000
Proceeds from contributions restricted to endowment	<u>2,120,668</u>	<u>4,347,290</u>
Net cash provided by financing activities	<u>3,339,668</u>	<u>2,761,290</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(134,828)	20,011
Cash and cash equivalents, beginning of year	<u>240,273</u>	<u>220,262</u>
Cash and cash equivalents, end of year	<u>\$ 105,445</u>	<u>\$ 240,273</u>
<i>Supplemental disclosure of cash flow information:</i>		
Cash paid for interest	\$210,151	\$427,748
Contributed securities	\$126,319	\$82,882

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, 2009 and 2008

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 a trust established 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 – The financial statements include the consolidated statements of financial position, of activities, and of cash flows for the Society and the Endowment (collectively referred to as the Symphony). All balances and transactions between the consolidated entities have been eliminated.

Federal income tax status – The Society and 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).

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 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, 2009 and 2008, all temporarily restricted net assets are for future time periods.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Investment return may be used to support the operations of the Symphony.

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.

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. 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 pledges receivable.

Property is recorded 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 valued based on quoted market prices. Investments in funds of funds and limited partnership funds (collectively, alternative investments), which are not readily marketable, are reported at estimated fair values, as provided by the investment managers. Those estimated values may differ significantly from the values that would have been used had a ready market existed for these securities. 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.

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 revenues are recognized.

Contributions, including government grants, are recorded 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 temporary 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 recorded 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 2009 and 2008, the Symphony paid approximately \$724,000 and \$768,000, respectively, for advertising costs. At May 31, 2009 and 2008, prepaid expenses include deferred advertising costs of approximately \$71,000 and \$12,000, respectively.

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, 2009 consist of the following:

	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
Pledges receivable are expected to be collected as follows:			
Less than one year	\$ 2,973,736	\$ 4,032,684	\$ 7,006,420
One to five years	467,500	2,626,000	3,093,500
Six to seven years		100,000	100,000
	<u>3,441,236</u>	<u>6,758,684</u>	<u>10,199,920</u>
Total pledges receivable	3,441,236	6,758,684	10,199,920
Unamortized discount	(10,474)	(118,931)	(129,405)
Allowance for uncollectible pledges receivable	<u>(60,000)</u>	<u>(20,000)</u>	<u>(80,000)</u>
Pledges receivable, net	<u>\$ 3,370,762</u>	<u>\$ 6,619,753</u>	<u>\$ 9,990,515</u>

Pledges receivable at May 31, 2008 consist of the following:

	HOUSTON SYMPHONY SOCIETY	HOUSTON SYMPHONY ENDOWMENT	TOTAL
Total pledges receivable	\$ 5,020,580	\$ 8,776,001	\$ 13,796,581
Unamortized discount	(36,627)	(279,125)	(315,752)
Allowance for uncollectible pledges receivable	<u>(60,000)</u>	<u>(16,141)</u>	<u>(76,141)</u>
Pledges receivable, net	<u>\$ 4,923,953</u>	<u>\$ 8,480,735</u>	<u>\$ 13,404,688</u>

The Brown Foundation made a conditional pledge of \$9,000,000 in February 2005. The grant was payable 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. In 2009, the term of this gift was extended to February 2010. This grant and matching contributions will be permanently restricted. The matching funds raised must be specifically designated by the donors as funds to match this grant. The Symphony will record this contribution as the matching requirements are substantially met. As of May 31, 2009, \$6,750,000 has been recognized for the pledge and \$2,250,000 remains conditional upon raising the required matching funds.

NOTE 3 – PROPERTY

Property consists of the following:

	<u>2009</u>	<u>2008</u>
Land	\$ 16,915	\$ 16,915
Computer and information systems	1,076,032	1,072,699
Instruments	724,381	676,994
Leasehold improvements	219,244	189,071
Furniture and equipment	<u>95,258</u>	<u>95,258</u>
Total property, at cost	2,131,830	2,050,937
Accumulated depreciation	<u>(1,535,209)</u>	<u>(1,354,635)</u>
Property, net	<u>\$ 596,621</u>	<u>\$ 696,302</u>

NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>Liquidity</u>	<u>2009</u>	<u>2008</u>
Mutual funds:			
TIFF Multi-Asset Fund	Monthly	\$ 29,001,973	\$ 36,142,607
Other	Daily	1,641,102	3,688,716
Equity securities	Daily		10,029
Alternative investments:			
The Endowment Fund	Quarterly (with possible restrictions)	1,867,399	2,343,199
Common Fund:			
Equity Fund	Monthly	10,029,611	14,250,002
Bond Fund	Monthly	6,009,389	6,211,783
Commodities Fund	Monthly	758,199	1,297,679
Hedged Investors Fund	Quarterly	1,045,833	1,205,502
Global Hedge Fund	Annually (with possible restrictions)	1,084,142	1,205,509
Cash and cash equivalents		185,917	260,332
Land held for investment		<u>480,000</u>	<u>480,000</u>
Total investments		<u>\$ 52,103,565</u>	<u>\$ 67,095,358</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.

Alternative investments include certain funds of funds and limited partnership funds. Funds of funds and limited partnership funds 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 alternative 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.

Investment return consists of the following:

	<u>2009</u>	<u>2008</u>
Interest and dividends	\$ 1,460,978	\$ 2,109,000
Net realized gain	8,148	3,233,246
Net unrealized loss	(14,586,250)	(2,671,434)
Rents	60,000	60,611
Royalties	66,968	70,740
Investment fees	<u>(113,550)</u>	<u>(108,533)</u>
Total	<u>\$ (13,103,706)</u>	<u>\$ 2,693,630</u>

NOTE 5 – FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Symphony adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which establishes a framework for measuring fair value. SFAS 157 establishes a three-tiered hierarchy that prioritizes the assumptions, referred to as inputs, used to measure fair value.

The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

- *Level 1* – Pricing inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Symphony has the ability to access at the reporting date.
- *Level 2* – Pricing inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for an asset or liability, inputs derived principally from or corroborated by observable market data by correlation or other means.
- *Level 3* – Pricing inputs are unobservable and are significant to the fair value measurement.

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

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Mutual funds	\$ 1,641,102		\$ 29,001,973	\$ 30,643,075
Hedge funds and fund of funds			20,794,573	20,794,573
Money market mutual funds	<u>185,917</u>			<u>185,917</u>
Total assets measured at fair value	<u>\$ 1,827,019</u>	<u>\$ 0</u>	<u>\$ 49,796,546</u>	<u>\$ 51,623,565</u>

Liabilities measured at fair value as of May 31, 2009 are as follows:

Interest rate swap agreement		<u>\$ (62,998)</u>		<u>\$ (62,998)</u>
Total	<u>\$ 0</u>	<u>\$ (62,998)</u>	<u>\$ 0</u>	<u>\$ (62,998)</u>

The inputs used to measure the fair value of investments are not necessarily indicative of the risk of investing in a particular security. The inputs used may produce a fair value measurement 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.

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

- *Mutual funds* are valued at the reported net asset value.
- *Hedge funds and funds of funds* are valued at the reported net asset value as determined by the issuer and the values reported in the audited financial statements.
- *Interest rate swap* is valued based upon market interest rates and the expected cash flows of the swap based on Eurodollar futures.

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

Balance at May 31, 2008	\$ 62,656,281
Net realized and unrealized losses	(14,240,228)
Purchases, sales, issuances and settlements, net	<u>1,380,493</u>
Balance at May 31, 2009	<u>\$ 49,796,546</u>

NOTE 6 – NOTE PAYABLE

Note payable represents the outstanding balance on an \$8,500,000 line of credit that expires December 31, 2010. Interest is payable monthly at a variable rate equal to 1.35% over LIBOR (1.7775% at May 31, 2009). 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 can not exceed 75%.

To reduce its exposure to interest rate volatility, the Symphony entered into an interest rate swap agreement with the financing institution in a notional amount of \$4.5 million on May 30, 2008. Effective May 30, 2009, the notional amount of this agreement decreased to \$2.0 million. The instrument fixes the interest rate at 4.57% through May 30, 2010. Interest is payable monthly. In the event the Symphony terminates this swap agreement prior to maturity, an early termination fee will be incurred.

Effective July 30, 2009, the Symphony entered into an additional interest note swap agreement in a notional amount of \$4.0 million. This instrument has a fixed rate of 2.32% through July 2010.

NOTE 7 – OPERATING LEASE COMMITMENTS

The Symphony leases its facilities under noncancelable operating lease agreements. Future minimum lease payments under these operating leases as of May 31, 2009 are as follows:

2010	\$ 170,903
2011	125,632
2012	113,819
2013	<u>16,203</u>
Total	<u>\$ 426,557</u>

Lease expense for 2009 and 2008 was \$257,391 and \$198,345, respectively.

NOTE 8 – ENDOWMENT

Effective July 1, 2008, the Symphony 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 uses the term endowment to refer to a fund established to provide income for the maintenance of an organization whether those funds are permanently or temporarily restricted by the donor or are unrestricted assets set aside by board designation.

The Houston Symphony Endowment (Endowment) was established for the purpose of supporting the Houston Symphony 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 retention 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 permanently restricted. As a result of this interpretation, the Symphony classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) accumulation 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 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 determination to appropriate accumulated donor-restricted endowment funds:

- The duration and preservation of the Endowment
- 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:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, May 31, 2007	\$ 13,706,687		\$ 59,424,858	\$ 73,131,545
Reclassification based on change in law	<u>(13,706,687)</u>	<u>\$ 13,706,687</u>		
Endowment net assets after reclassification	<u>0</u>	<u>13,706,687</u>	<u>59,424,858</u>	<u>73,131,545</u>
Contributions			<u>5,404,993</u>	<u>5,404,993</u>
Investment return:				
Interest and dividends		2,240,353		2,240,353
Net realized and unrealized gain		538,986	22,826	561,812
Investment management fees		<u>(108,533)</u>		<u>(108,533)</u>
Net investment return		<u>2,670,806</u>	<u>22,826</u>	<u>2,693,632</u>
Distributions		<u>(3,881,020)</u>		<u>(3,881,020)</u>
Endowment net assets, May 31, 2008	<u>0</u>	<u>12,496,473</u>	<u>64,852,677</u>	<u>77,349,150</u>
Contributions			<u>259,686</u>	<u>259,686</u>
Investment return:				
Interest and dividends		1,587,946		1,587,946
Net realized and unrealized loss	(4,564,580)	(9,606,526)	(406,996)	(14,578,102)
Investment management fees		<u>(113,550)</u>		<u>(113,550)</u>
Net investment return	<u>(4,564,580)</u>	<u>(8,132,130)</u>	<u>(406,996)</u>	<u>(13,103,706)</u>
Distributions		<u>(4,364,343)</u>		<u>(4,364,343)</u>
Endowment net assets, May 31, 2009	<u>\$ (4,564,580)</u>	<u>\$ 0</u>	<u>\$ 64,705,367</u>	<u>\$ 60,140,787</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 that are reported in unrestricted net assets were approximately \$4.6 million as of May 31, 2009. These deficiencies resulted from unfavorable market fluctuations that occurred during the last year and continued appropriation for operations that was deemed prudent by the Board of Directors. There were no such deficiencies as of May 31, 2008.

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 organization must hold in perpetuity or for donor-specified period(s).

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 with 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 assets 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 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 trustees 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.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (FASB 158)*, an amendment of FASB Statements No. 87, 88, and 132. These changes were made to improve financial reporting by requiring an employer to recognize the funded status of a defined benefit plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which changes occur through changes in unrestricted net assets. The statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. The Symphony adopted these changes during the year ended May 31, 2008.

The required disclosures under FASB 158 are as follows:

	MUSICIANS PLAN 2009	STAFF EMPLOYEES 2009	MUSICIANS PLAN 2008	STAFF EMPLOYEES 2008
The funded status of each plan is as follows:				
Projected benefit obligation	\$ 14,754,015	\$ 3,375,877	\$ 14,606,172	\$ 3,046,183
Fair value of plan assets	<u>(8,008,291)</u>	<u>(1,722,832)</u>	<u>(11,623,814)</u>	<u>(2,382,599)</u>
Unfunded projected benefit obligation	\$ <u>(6,745,724)</u>	\$ <u>(1,653,045)</u>	\$ <u>(2,982,358)</u>	\$ <u>(663,584)</u>
Accumulated benefit obligation	\$ <u>(14,754,015)</u>	\$ <u>(3,171,568)</u>	\$ <u>(14,606,172)</u>	\$ <u>(2,852,091)</u>

Amounts previously recognized in unrestricted net assets, not yet recognized as periodic pension cost:

	MUSICIANS PLAN 2009	STAFF PLAN 2009	MUSICIANS PLAN 2008	STAFF PLAN 2008
Net loss	\$ 10,082,676	\$ 1,670,059	\$ 6,162,080	\$ 720,928
Prior service cost	<u>70,847</u>	<u> </u>	<u>101,942</u>	<u> </u>
Total	\$ <u>10,153,523</u>	\$ <u>1,670,059</u>	\$ <u>6,264,022</u>	\$ <u>720,928</u>

Components of net periodic benefit cost:

	MUSICIANS PLAN 2009	STAFF PLAN 2009	MUSICIANS PLAN 2008	STAFF PLAN 2008
Interest cost	\$ 865,276	\$ 186,939	\$ 856,244	\$ 169,312
Service cost		136,310		111,099
Expected return on assets	(940,215)	(198,871)	(850,538)	(163,794)
Amortization of prior service cost	31,095		69,182	
Amortization of loss	<u>487,709</u>	<u>87,359</u>	<u>476,967</u>	<u>85,757</u>
Total net periodic benefit cost	\$ <u>443,865</u>	\$ <u>211,737</u>	\$ <u>551,855</u>	\$ <u>202,374</u>

Other changes in plan assets and benefit obligations recognized in changes in net assets:

	MUSICIANS PLAN 2009	STAFF PLAN 2009	MUSICIANS PLAN 2008	STAFF PLAN 2008
Net gain	\$ 4,379,380	\$ 1,030,965	\$ 1,256,595	\$ 383,249
Amortization of prior service cost	(31,095)		(69,182)	
Amortization of net loss	<u>(458,784)</u>	<u>(81,834)</u>	<u>(537,211)</u>	<u>(97,254)</u>
Total recognized in changes in net assets	\$ <u>3,889,501</u>	\$ <u>949,131</u>	\$ <u>650,202</u>	\$ <u>285,995</u>

The estimated transition assets, prior service credit, and actuarial gain from the pension plan that will be amortized into net periodic benefit cost over the next fiscal year are \$0, \$0, and \$185,000 for the Staff Plan and \$0, \$24,187, and \$734,000 for the Musicians Plan, respectively.

	MUSICIANS PLAN 2009	STAFF EMPLOYEES 2009	MUSICIANS PLAN 2008	STAFF EMPLOYEES 2008
Weighted-average assumptions used to determine benefit obligation at year end:				
Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%

Weighted-average assumptions used to determine net periodic cost at year end:

Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Average future working lifetime	9.54	5.34	10.11	5.29

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 Symphony’s actual pension plan asset allocation by type of asset is as follows:

	MUSICIANS PLAN <u>2009</u>	STAFF EMPLOYEES <u>2009</u>	MUSICIANS PLAN <u>2008</u>	STAFF EMPLOYEES <u>2008</u>
Equity	53.7%	53.7%	60.3%	60.3%
Fixed income	29.6%	29.6%	25.8%	25.8%
Cash	.1%	.1%	.1%	.1%
Other	<u>16.6%</u>	<u>16.6%</u>	<u>13.8%</u>	<u>13.8%</u>
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

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 shall be 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%

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 Plan totaled \$741,407 in 2009 and \$1,607,758 in 2008. Additionally, the Symphony paid to AFM on behalf of the musicians, a total of \$410,231 in 2009 and \$396,741 in 2008. Distributions from the Plans during 2009 and 2008 were \$1,191,088 and \$1,153,795, respectively.

Estimated future benefit payments are as follows:

	MUSICIANS PLAN	STAFF EMPLOYEES
2009	\$ 1,074,107	\$ 127,593
2010	1,069,247	137,345
2011	1,063,800	137,947
2012	1,069,125	166,285
2013	1,090,304	187,694
2014 through 2018	<u>5,359,051</u>	<u>1,178,908</u>
Total	<u>\$ 10,725,634</u>	<u>\$ 1,935,772</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 June 2007, a new agreement was reached and all terms were finalized through October 2010. In 2009, the Symphony and the musicians negotiated a modification to the final year of the collective bargaining agreement.