

# San Francisco Ballet Association

Consolidated Financial Statements as of  
and for the Year Ended June 30, 2007, and  
Independent Auditors' Report

## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of  
San Francisco Ballet Association  
San Francisco, CA

We have audited the accompanying consolidated statement of financial position of the San Francisco Ballet Association (the "Ballet") as of June 30, 2007, and the related consolidated statements of activities and changes in net assets and of cash flows for the year then ended. These consolidated financial statements are the responsibility of the Ballet's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the Ballet's 2006 consolidated financial statements and, in our report dated November 15, 2006, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Ballet's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Ballet as of June 30, 2007, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Deloitte + Touche LLP*

October 31, 2007  
(July 23, 2008, as to Note 13)

# SAN FRANCISCO BALLET ASSOCIATION

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2007

(With summarized financial information as of June 30, 2006)

	2007	2006
<b>ASSETS</b>		
CASH AND CASH EQUIVALENTS	\$ 6,445,755	\$ 6,689,764
ACCOUNTS RECEIVABLE	325,395	309,314
PREPAID EXPENSES AND DEPOSITS	1,545,880	1,038,181
PLEDGES RECEIVABLE — Net	10,490,222	7,144,903
RECEIVABLES FROM SPLIT INTEREST AGREEMENTS — Net	4,875,918	4,695,217
OTHER ASSETS	323,188	300,000
RESTRICTED CASH	16,399,505	562,928
BOND ISSUANCE COSTS — Net	1,672,855	382,440
PROPERTY AND EQUIPMENT — Net	29,968,126	23,093,943
ENDOWMENT INVESTMENTS	<u>88,420,185</u>	<u>69,726,295</u>
TOTAL	<u>\$ 160,467,029</u>	<u>\$ 113,942,985</u>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 4,036,277	\$ 3,142,681
Line of credit		1,368,158
Capital lease obligation	3,031,413	
Deferred performance and school revenue	3,500,998	2,940,201
Interest rate swap liability	120,733	52,000
Bonds payable	<u>44,000,000</u>	<u>19,540,000</u>
Total liabilities	<u>54,689,421</u>	<u>27,043,040</u>
NET ASSETS:		
Unrestricted	38,187,724	33,063,556
Temporarily restricted	18,718,009	13,994,347
Permanently restricted	<u>48,871,875</u>	<u>39,842,042</u>
Total net assets	<u>105,777,608</u>	<u>86,899,945</u>
TOTAL	<u>\$ 160,467,029</u>	<u>\$ 113,942,985</u>

See notes to consolidated financial statements.

# SAN FRANCISCO BALLET ASSOCIATION

## CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2007

(With summarized financial information for the year ended June 30, 2006)

	2007			Total	2006 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
<b>OPERATING REVENUES:</b>					
San Francisco performance	\$ 14,776,227	\$ -	\$ -	\$ 14,776,227	\$ 14,170,570
Touring	291,436			291,436	402,500
School and student housing	1,433,600			1,433,600	1,443,593
Postage and handling fees	402,402			402,402	425,353
Sales and rentals — net	215,506			215,506	222,329
Endowment returns transferred to operations	5,971,628			5,971,628	4,309,651
Dividend and interest income	1,228,715			1,228,715	154,567
Other income	60,102			60,102	240,458
<b>Total operating revenues</b>	<b>24,379,616</b>	<b>-</b>	<b>-</b>	<b>24,379,616</b>	<b>21,369,021</b>
<b>OPERATING EXPENSES:</b>					
Program services:					
Ballet production	23,362,642			23,362,642	21,978,076
Touring	1,070,846			1,070,846	830,966
School and student housing	3,530,538			3,530,538	2,855,555
Education and outreach	444,877			444,877	461,160
<b>Total program services</b>	<b>28,408,903</b>	<b>-</b>	<b>-</b>	<b>28,408,903</b>	<b>26,125,757</b>
Support services:					
Marketing, publicity, and audience development	3,883,286			3,883,286	3,518,921
General and administrative	4,362,059			4,362,059	3,801,133
Fundraising	1,921,658			1,921,658	1,636,375
<b>Total support services</b>	<b>10,167,003</b>	<b>-</b>	<b>-</b>	<b>10,167,003</b>	<b>8,956,429</b>
Net realized and unrealized losses (gains) on interest rate swap	249,469			249,469	(630,153)
<b>Total operating expenses</b>	<b>38,825,375</b>	<b>-</b>	<b>-</b>	<b>38,825,375</b>	<b>34,452,033</b>
<b>Operating revenues less operating expenses</b>	<b>(14,445,759)</b>	<b>-</b>	<b>-</b>	<b>(14,445,759)</b>	<b>(13,083,012)</b>
<b>CONTRIBUTIONS IN SUPPORT OF OPERATIONS:</b>					
Contributions	9,476,843	5,995,723		15,472,566	11,499,677
Special events and auxiliary activities — net	1,483,936			1,483,936	1,745,741
Net assets released from restrictions	3,684,861	(3,684,861)			
<b>Total contributions in support of operations</b>	<b>14,645,640</b>	<b>2,310,862</b>	<b>-</b>	<b>16,956,502</b>	<b>13,245,418</b>
<b>CHANGE IN NET ASSETS FROM OPERATIONS</b>	<b>199,881</b>	<b>2,310,862</b>	<b>-</b>	<b>2,510,743</b>	<b>162,406</b>
<b>ENDOWMENT:</b>					
Contributions	1,092,463	2,459,897	7,938,297	11,490,657	1,539,107
Endowment management and expenses	(1,289,421)			(1,289,421)	(498,827)
Investment return after transfers to operations	3,983,738	1,090,410	1,151,536	6,225,684	2,661,052
Write off of pledges receivable			(60,000)	(60,000)	(50,069)
Net assets released from restrictions	1,137,507	(1,137,507)			
<b>Change in net assets from endowment</b>	<b>4,924,287</b>	<b>2,412,800</b>	<b>9,029,833</b>	<b>16,366,920</b>	<b>3,651,263</b>
<b>INCREASE IN NET ASSETS</b>	<b>5,124,168</b>	<b>4,723,662</b>	<b>9,029,833</b>	<b>18,877,663</b>	<b>3,813,669</b>
<b>NET ASSETS — Beginning of year</b>	<b>33,063,556</b>	<b>13,994,347</b>	<b>39,842,042</b>	<b>86,899,945</b>	<b>83,086,276</b>
<b>NET ASSETS — End of year</b>	<b>\$ 38,187,724</b>	<b>\$ 18,718,009</b>	<b>\$ 48,871,875</b>	<b>\$ 105,777,608</b>	<b>\$ 86,899,945</b>

See notes to consolidated financial statements.

# SAN FRANCISCO BALLET ASSOCIATION

## CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2007

(With summarized financial information for the year ended June 30, 2006)

	2007	2006
OPERATING ACTIVITIES:		
Increase in net assets	\$ 18,877,663	\$ 3,813,669
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Permanently restricted contributions received	(9,008,826)	(488,000)
Depreciation	1,579,053	1,867,834
Amortization of bond issuance costs	53,952	14,709
Write off of bond issuance costs	381,214	
Net realized and unrealized gains on marketable investments	(7,795,481)	(4,495,801)
Limited partnership investment gains — net	(2,026,906)	(1,193,120)
Change in allowance for doubtful pledges receivable	(71,931)	135,531
Change in discount of pledges receivable	90,702	
Change in interest rate swap mark-to-market	120,733	(702,862)
Settlement of interest rate swap liability	(52,000)	
Investment income restricted for long-term purposes	(877,522)	(27,395)
Net effect of changes in:		
Accounts receivable	(16,081)	14,667
Prepaid expenses and deposits	(507,699)	2,247,465
Pledges receivable	(3,364,090)	144,078
Receivables from split interest agreements	(180,701)	(28,101)
Other assets	(23,188)	
Accounts payable and accrued expenses	893,596	659,257
Deferred performance and school revenue	560,797	(2,018,982)
	<u>(1,366,715)</u>	<u>(57,051)</u>
Net cash used in operating activities		
INVESTING ACTIVITIES:		
Purchases of endowment investments	(23,892,971)	(21,314,654)
Proceeds from sales of endowment investments	15,021,468	20,612,380
Purchases of restricted cash	(42,578,252)	
Uses of restricted cash	27,619,197	557,455
Acquisitions of property and equipment	(5,300,792)	(381,408)
	<u>(29,131,350)</u>	<u>(526,227)</u>
Net cash used in investing activities		
FINANCING ACTIVITIES:		
Permanently restricted contributions received	9,008,826	488,000
Principal payment on capital lease obligation	(121,031)	
(Repayment) borrowing on line of credit	(1,368,158)	1,368,158
Bond proceeds received	44,000,000	
Bonds refunded	(19,540,000)	
Payment of bond issuance costs	(1,725,581)	
	<u>30,254,056</u>	<u>1,856,158</u>
Net cash provided by financing activities		
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(244,009)	1,272,880
CASH AND CASH EQUIVALENTS — Beginning of year	<u>6,689,764</u>	<u>5,416,884</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 6,445,755</u>	<u>\$ 6,689,764</u>
SUPPLEMENTAL DISCLOSURES:		
Property acquired under capital lease	<u>\$ 3,152,444</u>	<u>\$ -</u>
Cash paid during the year for interest	<u>\$ 1,576,597</u>	<u>\$ 630,214</u>

See notes to consolidated financial statements.

# SAN FRANCISCO BALLET ASSOCIATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2007

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization** — San Francisco Ballet Association (the “Association”) operates both a dance company and a ballet school. As America’s oldest professional ballet company and one of the three largest ballet companies in the United States with its roster of seventy-eight dancers as of June 30, 2007, the Association has enjoyed a long and rich tradition of artistic “firsts.” It performed the first American productions of *Swan Lake* and *Nutcracker*, as well as the first production of *Coppélia* choreographed by an American choreographer. Guided in its early years by American dance pioneers and brothers Lew, Willam, and Harold Christensen, the Association currently presents more than 100 performances annually, in San Francisco, California, and other communities in the Bay Area, as well as annual tours to domestic and international locations. San Francisco Ballet Endowment Foundation (the “Foundation”), a separate legal entity, holds the assets of the endowment for the benefit of the Association. The Association and the Foundation (collectively, the “Ballet”) are California not-for-profit corporations founded in 1933 and 1980, respectively.

**Principles of Consolidation** — The accompanying consolidated financial statements include the financial position, changes in net assets, and cash flows of the Association and the Foundation because the Association has both control of and economic interest in the Foundation. Interorganizational transactions and accounts have been eliminated in consolidation.

**Basis of Presentation** — The accompanying consolidated financial statements are presented on the basis of unrestricted, temporarily restricted, and permanently restricted net assets.

**Cash and Cash Equivalents** — Cash and cash equivalents consist of demand deposits and highly liquid investments purchased with a maturity of three months or less.

**Pledges Receivable** — Pledges receivable consist of unconditional promises to give that are expected to be collected in future years. Such receivables are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free rates applicable in the years in which those promises were received. Amortization of the discounts is included in contributions in the accompanying consolidated statement of activities and changes in net assets.

**Receivables From Split Interest Agreements** — Receivables from split interest agreements represent the Ballet’s irrevocable remainder interests in a pooled income fund and various trusts held by third-party trustees. These receivables are stated at estimated fair value, which is measured as the present value of the estimated future distributions expected to be received over the expected terms of the agreements. In determining the fair value, the Ballet considers single or joint life expectancy from the Society of Actuaries’ 1983 Group Annuity Mortality Table and RP-2000 Mortality Table, the estimated return on the invested assets during the expected term of the agreements, the contractual payment obligations under the agreements, and a discount rate reflective of current market conditions. The estimation of the fair value of these receivables is subjective and requires significant judgment. Due to uncertainties inherent in the estimation process, it is possible that future events in either the near or long term could materially affect the amounts reported in the consolidated statement of financial position.

**Bond Issuance Costs** — Bond issuance costs are being amortized over the term of the bonds payable.

**Other Assets** — Other assets consists primarily of certificates of deposits with maturities greater than three months.

**Restricted Cash** — Restricted cash is invested in a money market fund that is held by a trustee in restricted accounts established with proceeds received from the bonds payable.

**Property and Equipment** — Property and equipment are stated at cost. Donated property and equipment is recorded at estimated fair value at the date of receipt. The building and improvements are being depreciated on a straight-line basis over 20 to 40 years. Depreciation of furniture and equipment is computed on the straight-line basis over the estimated useful life of the assets, generally 3 to 10 years.

Fixed assets that are donated or acquired with resources restricted for such acquisition are considered to be temporarily restricted and are released from restrictions over the estimated useful life of the asset.

Maintenance expenses and all costs for new productions, including sets, costumes, and choreography, are charged to expense as incurred or in the year of initial performance with the exception of costs associated with full-length works. Full-length works are capitalized and depreciated on a straight-line basis over the first two years the new works are presented. The Ballet's new production of *Nutcracker*, including the costs for sets, costumes, staging, and choreography, completed in 2005, is being depreciated on a straight-line basis over 15 years.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Buildings and improvements include a capital lease for a warehouse of approximately \$3,150,000 as of June 30, 2007, which is the present value at the beginning of the lease term of the aggregate future minimum lease payments. The amortization of such assets is included in depreciation expense. The accumulated amortization on assets under capital leases was \$26,000 as of June 30, 2007.

**Endowment Investments** — Endowment investments consist of equity and fixed income investments, limited partnership investments, unsettled trades, and cash and cash equivalent balances restricted by donors or designated by the Association's Board of Trustees for long-term investment. Investments in equity and debt securities are stated at estimated fair value based on quoted market prices. Other investments, such as limited partnership interests, are also recorded at estimated fair value. Limited partnership interests include nonmarketable and/or restricted investment securities whose values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the managing partner of the limited partnership. Because of the inherent uncertainty of valuation of nonmarketable and restricted investments, those estimated fair values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

Gains or losses that result from market fluctuations are recognized in the period such fluctuations occur. Dividend and interest income is recognized when earned.

**Deferred Performance and School Revenue** — Deferred performance and school revenue at June 30, 2007 primarily consists of advance ticket sales for performances scheduled in the Ballet's 2008 repertory season, which opens in January 2008, as well as advance tuition payments for school classes to be conducted in the year ending June 30, 2008.

**Derivative Instrument** — The Ballet has an interest rate swap agreement (“Swap Agreement”), which is considered a derivative instrument, to manage the interest rate exposure of its bonds by minimizing its exposure to volatility in the market. The Swap Agreement is reflected in the consolidated statement of financial position at estimated fair value. Payments made under this agreement are recorded as net realized and unrealized losses (gains) on interest rate swap in the consolidated statement of activities and changes in net assets.

**Unrestricted Net Assets** — Unrestricted net assets are available to support all activities of the Ballet.

**Temporarily Restricted Net Assets** — Temporarily restricted net assets represent contributions whose use is limited by donor-imposed stipulations that expire by the passage of time or can be fulfilled and removed by actions of the Ballet pursuant to those stipulations.

**Permanently Restricted Net Assets** — Permanently restricted net assets represent contributions whose use is limited by donor-imposed stipulations that require the gift to be invested in perpetuity. The income from such invested assets, including realized and unrealized gains, is generally available to support the activities of the Ballet.

**Sales and Rentals** — Sales and rentals are presented net of costs of approximately \$528,600 for the year ended June 30, 2007.

**Revenue Recognition** — All contributions are recognized as revenue when received or unconditionally promised to the Ballet. The Ballet classifies gifts of cash and other assets as temporarily or permanently restricted support if received with donor stipulations that limit the use of the contributions. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted contributions are reported as unrestricted support when the restriction is met in the same period as the contribution is received. Conditional promises to give are not recognized as revenue until the conditions are substantially met. There were no conditional promises at June 30, 2007.

Investments received as gifts are initially recorded at estimated fair value at the date of donation. The Ballet’s irrevocable interest in split interest agreements is recognized as revenue at the time such agreements are made known to the Ballet.

**Contributions of Services** — Contributions of services are recognized when received if such services (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 donated. During the year ended June 30, 2007, the value of contributed services recognized as revenues in the accompanying consolidated financial statements was approximately \$442,000 and consisted primarily of donated legal, investment advisory and design services, and travel vouchers. Of this amount, \$354,000 for legal and investment advisory services was received from related parties. In addition, a substantial number of volunteers have donated significant amounts of time in the Ballet’s program services and fund-raising activities through participation in the Auxiliary, Encore!, and Ballet Resource and Volunteer Organization (BRAVO). The value of donated volunteer services has not been recognized in the accompanying consolidated financial statements because such volunteer services do not meet the criteria described above.

**Special Events and Auxiliary Activities** — Special events and auxiliary activities are presented net of costs of approximately \$1,656,200 for the year ended June 30, 2007, including donated food, beverages, and catering services of approximately \$351,000.

**Functional Expense Allocations** — Expenses, such as depreciation, interest expense on bonds payable, supplies, travel, personnel, and occupancy costs, are allocated among program services and support services on the basis of occupancy ratios and on estimates made by the Ballet's management.

**Collective Bargaining Agreements** — Approximately 87% (942 employees) of the Ballet's employees are covered by collective bargaining agreements. Of these employees, 98 are covered under an agreement that expired on July 31, 2007, and 187 employees are covered under an agreement that will expire on November 30, 2007. The renewal of both of these agreements was ratified in October 2007. Additionally, 27 employees are covered under an agreement that will expire on June 30, 2008.

**Income Tax Status** — The Association and the Foundation have both been classified as publicly supported, tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code, and are exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d).

**Fair Value of Financial Instruments** — The Ballet's financial instruments include cash, cash equivalents, certificates of deposit, accounts receivable, pledges receivable, receivables from split interest agreements, endowment investments, accounts payable and accrued expenses, a Swap Agreement, and bonds payable. For cash, cash equivalents, accounts receivable, and accounts payable and accrued expenses, the carrying amounts approximate fair value because of the short maturity of these items. Endowment investments, pledges receivable, receivables from split interest agreements, and the Swap Agreement are reflected at their estimated fair values using methodologies described above. The carrying amount of the bonds payable and certificates of deposit represents a reasonable estimate of the corresponding fair value due to the associated variable interest rate.

**Concentrations of Credit Risk** — Financial instruments that potentially subject the Ballet to credit risk consist primarily of cash, cash equivalents, accounts and pledges receivable, and investments. The Ballet maintains cash and cash equivalents with major financial institutions. At times, such amounts may exceed Federal Depository Insurance Corporation limits. The Ballet's investments have been placed with a major custodian. The Ballet closely monitors these investments and its accounts and pledges receivable and has not experienced significant credit losses. As of June 30, 2007, pledges receivable include approximately \$4,726,000 due from members of the Association's Board of Trustees and of the Foundation's Board of Directors.

**Use of Estimates** — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. As disclosed above, estimates are used for, but not limited to, accounts and pledges receivable valuation, split interest agreement receivables valuation, depreciable lives of property and equipment, fair value of endowment investments and fair value of the Swap Agreement. Actual results could differ from those estimates.

**Comparative Presentation** — The consolidated financial statements include certain prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Ballet's consolidated financial statements for the year ended June 30, 2006, from which the summarized information was derived.

## 2. PLEDGES RECEIVABLE

Pledges receivable at June 30, 2007 are due as follows:

<b>Years Ending June 30</b>	
2008	\$ 4,831,978
2009–2012	<u>6,124,072</u>
Total pledges receivable	10,956,050
Allowance for doubtful pledges receivable	(63,600)
Discount for amounts expected to be collected after one year	<u>(402,228)</u>
Pledges receivable — net	<u>\$ 10,490,222</u>

## 3. ENDOWMENT INVESTMENTS

The endowment investments consist of the following components: (1) permanently restricted investments, which represent the historic dollar value of contributions restricted by donors for permanent investment, (2) temporarily restricted investments from the reinvested net income of endowment investments whose earnings have been restricted by donors for specific purposes, and (3) unrestricted endowment investments, which represent funds directed for investment in the endowment by the Association's Board of Trustees and the net income from unrestricted endowment investments after expenses associated with raising and managing the endowment funds.

A portion of the accumulated net investment return from the endowment investments is transferred for use in the Ballet's operations each year based on a transfer rate established by the Foundation's Board of Directors (the "Operating Transfer"). For the year ended June 30, 2007, the Operating Transfer was based on a transfer rate of 5% applied to the average of the estimated fair value of the total endowment investments as of March 31, 2004, 2005, and 2006. In addition to the Operating Transfer of approximately \$3,208,000, the Foundation's Board of Directors also approved a supplemental transfer of approximately \$2,763,000, which is equivalent to a transfer rate of 4.25% applied to the average of the estimated fair value of the total endowment investments as of March 31, 2004, 2005, and 2006, for the year ended June 30, 2007.

Endowment investments at June 30, 2007, at estimated fair value, consist of the following:

Equity investments	\$ 46,551,873
Fixed income investments	15,569,633
Limited partnership investments	15,470,229
Unsettled trades	8,000,000
Cash and cash equivalents held for investment	<u>2,828,450</u>
Total endowment investments	<u>\$ 88,420,185</u>

Unsettled trades at June 30, 2007 are investments that settled in limited partnership investments as of July 1, 2007.

A member of the Foundation's Board of Directors is a General Partner of a limited partnership valued at \$11,730,437 at June 30, 2007 which is included in limited partnership investments above. A member of the Association's Board of Trustees is the Chief Executive Officer of the Foundation's investment custodian. These transactions were subject to customary arrangements regarding fees and, for the limited partnership, allocation of investment gains. A member of the Foundation's Board of Directors and Association's Board of Trustees is a partner in a law firm that provides legal counsel on the Foundation's planned giving matters. On July 1, 2007, the Chief Executive Officer of the Foundation's investment advisor became a member of the Association's Board of Trustees.

The investment return from the endowment investments for the year ended June 30, 2007, consists of the following:

Net realized and unrealized gains on marketable instruments	\$ 7,795,481
Limited partnership investment gains	2,026,906
Dividends and interest	<u>2,374,925</u>
 Total return on endowment investments	 12,197,312
 Amount transferred to operations	 <u>(5,971,628)</u>
 Investment return after transfers to operations	 <u>\$ 6,225,684</u>

#### 4. PROPERTY AND EQUIPMENT

The Ballet's property and equipment at June 30, 2007 is as follows:

Land	\$ 3,511,996
Buildings and improvements	30,512,426
Furniture and equipment	3,483,628
Capitalized sets and costumes	8,574,090
Construction in progress	<u>112,345</u>
 Total property and equipment	 46,194,485
 Accumulated depreciation	 <u>(16,226,359)</u>
 Property and equipment — net	 <u>\$ 29,968,126</u>

#### 5. CREDIT FACILITY

The Ballet has a line of credit with a bank of \$1,444,200, secured by certain investment securities in the Foundation's portfolio. Interest on the line of credit is charged at the prime rate minus 0.25%. The line of credit expires on April 30, 2008. The Ballet had no outstanding borrowings under the line of credit as of June 30, 2007.

## 6. BONDS PAYABLE

On August 2, 2006, the Ballet entered into an agreement with the California Infrastructure and Economic Development Bank for the issuance of \$44,000,000 in Variable Rate Revenue Bonds, Series 2006 (the “New Bonds”) and refunded the \$19,540,000 in Revenue Bonds, Series 2002 (the “Old Bonds”). The New Bonds bear interest at a variable rate reset daily (3.81% at June 30, 2007), mature on various dates from July 1, 2027 through July 1, 2036, are an unsecured obligation of the Ballet and the Foundation, and are insured by the Financial Guaranty Insurance Company.

A portion of the proceeds of the New Bonds were placed into an escrow account, which together with the restricted cash amounts remaining from the Old Bonds, had sufficient amounts to pay the principal due on the redemption or maturity date of the refunded Old Bonds. As a result of the refinancing, all of the refunded Old Bonds have been legally defeased and no longer represent obligations of the Ballet. Accordingly, the refunded Old Bonds and related escrow account are not included in the Ballet’s consolidated statement of financial position at June 30, 2007.

Two members of the Association’s Board of Trustees are partners in the law firm that acted as the Ballet’s counsel in the issuance of the New Bonds. Legal services were provided by this firm for the New Bonds issuance totaling approximately \$95,000, of which contributed legal services totaled approximately \$4,000.

Concurrent with the issuance of the New Bonds, the Ballet entered into a Swap Agreement, which effectively fixed the interest rate on a notional amount of \$22,000,000 at 3.922% for the remaining term of the New Bonds. At the same time, the Swap Agreement outstanding at June 30, 2006 was settled.

As a result of the above transaction, the statement of activities and changes in net assets reflects the write-off of the remaining bond issuance costs related to the Old Bonds of \$381,214 and the settlement of the Swap Agreement outstanding at June 30, 2006, for a cost of \$129,000.

At June 30, 2007, the fair market value of the New Bonds was quoted at \$44,000,000. Accumulated amortization as of June 30, 2007 related to the bond issuance costs of the New Bonds was \$53,952. Interest expense related to bonds payable for the year ended June 30, 2007 was approximately \$1,587,000. In connection with the New Bonds, the Ballet is required to be in compliance with certain financial covenants.

The remaining proceeds from the New Bonds are held in restricted cash accounts, and certain conditions must be met prior to the release of the funds. In addition to the refunding of the Old Bonds, the proceeds from the New Bonds are to be used for the purchase and renovation of a warehouse and a student residence, construction of ballet sets and costumes, a new full-length ballet production, certain technology hardware upgrades, reimbursement of costs for projects undertaken in connection with the Old Bonds, the payment of interest and fees, and costs incurred in connection with the issuance of the New Bonds. See Note 13.

The fair value of the Swap Agreement is estimated based on a quote from the market maker of this instrument and represents the estimated amounts the Ballet would expect to receive or pay to terminate the agreement. The estimated fair value of the Swap Agreement related to the New Bonds was approximately \$(121,000) at June 30, 2007, and is included in interest rate swap liability in the accompanying consolidated statement of financial position. Payments made to the counterparties of the Swap Agreements were approximately \$50,000 during the year ended June 30, 2007.

**7. TEMPORARILY RESTRICTED NET ASSETS AND NET ASSETS RELEASED FROM RESTRICTIONS**

As of June 30, 2007, temporarily restricted net assets were available for the following purposes:

For use in ensuing fiscal years	\$ 6,720,045
Property and equipment	5,262,322
75th Anniversary	3,200,000
New ballet production	1,352,340
Ballet school support	1,292,033
Education and outreach	445,574
Special events	444,675
Dancers' career transition	<u>1,020</u>
Total temporarily restricted net assets	<u>\$ 18,718,009</u>

Net assets were released from donor restrictions during the year ended June 30, 2007, by incurring expenses satisfying the restricted purposes specified by donors as follows:

Due to the expiration of time	\$ 2,782,991
Touring activities	598,000
Ballet school support	75,000
Property and equipment	372,422
New ballet production	950,000
Education and outreach	42,400
Dancers' career transition	<u>1,555</u>
Total net assets released from donor restrictions	<u>\$ 4,822,368</u>

**8. WORKERS' COMPENSATION**

The Ballet's workers' compensation insurance policies include self-insured retention limits and fully insured coverage above such limits. Accruals for claims under the Ballet's self-insured retention limits are recorded on a claim-incurred basis. The estimated liability for workers' compensation claims incurred but unpaid at June 30, 2007, of approximately \$1,569,000, is included in accounts payable and accrued expenses in the accompanying consolidated statement of financial position. At June 30, 2007, the Ballet had unused letters of credit totaling \$2,055,800, as required by the Ballet's insurance carriers.

**9. POSTRETIREMENT AND HEALTH AND WELFARE PLANS**

The Ballet has a defined contribution retirement plan that covers all eligible nonunion employees, and includes a 401(k) component. Contributions approximated \$277,100 for the year ended June 30, 2007, and were made at the discretion of the Ballet.

Substantially all theatrical employees are covered under collective bargaining agreements that require payments to multiemployer pension, health, and welfare plans. Contributions to these plans approximated \$2,035,000 for the year ended June 30, 2007.

## 10. LEASE COMMITMENTS

The Ballet rents a warehouse under a capital lease. In addition, the Ballet rents performance space, office space, and event venues under various operating leases. The following is a schedule of future minimum rental payments required under the leases that have an initial noncancelable lease term in excess of one year:

<b>Years Ending June 30</b>	<b>Capital</b>	<b>Operating</b>
2008	\$ 369,159	\$ 36,232
2009	369,159	37,263
2010	380,517	38,294
2011	380,517	34,297
2012	386,196	
2013–2017	<u>1,791,838</u>	<u>          </u>
Total	3,677,386	<u>\$ 146,086</u>
Less amounts representing interest at 4.10%	<u>(645,973)</u>	
Present value of obligations under capital leases	<u>\$ 3,031,413</u>	

Rent expense from operating leases approximated \$578,000 for the year ended June 30, 2007.

The Ballet has an option, which expires on February 28, 2009, to purchase the warehouse currently under capital lease. Until October 1, 2008, this option is contingent upon the landlord's readiness to sell. The Ballet intends to exercise its option as soon as practicable and to use proceeds from the New Bonds to purchase the warehouse, as described in Note 6.

## 11. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) released FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*. FIN No. 48 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. FIN No. 48 requires the evaluation of tax positions taken in the course of preparing the Ballet's tax returns to determine whether tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not-threshold would be recorded as a tax expense in the current year. Adoption of FIN No. 48 is required for fiscal years beginning after December 15, 2006, and is to be applied to all open tax years as of the effective date. At this time, the Ballet is evaluating the impact of FIN No. 48 and does not believe it will have a material affect on the consolidated financial statements.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. FASB Statement No. 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FASB Statement No. 157 is effective for fiscal years beginning after November 15, 2007. The Ballet is currently evaluating the impact of adopting FASB Statement No. 157 for its fiscal year beginning July 1, 2008.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*. FASB Statement No. 159 permits the Ballet to choose, at specified election dates, eligible items to measure at fair value (“Fair Value Option”). Unrealized gains and losses on items for which the Fair Value Option has been elected are reported in earnings. The Fair Value Option is applied instrument by instrument (with certain exceptions), is irrevocable (unless a new election date occurs), and is applied only to an entire instrument. If the Ballet elects the Fair Value Option provided for in FASB Statement No. 159, it would adopt this statement on July 1, 2008. The Ballet has not yet determined whether it will elect the option provided for in this statement, or the impact that the elective adoption may have on its consolidated financial position, operating results, or cash flows.

## **12. CONTINGENCIES**

The Ballet is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Ballet’s financial position or its changes in net assets.

## **13. SUBSEQUENT EVENT**

On June 20, 2008 the California Infrastructure and Economic Development Bank, Variable Rate Revenue Bonds, Series 2006 (the “New Bonds”) insurer, Financial Guaranty Insurance Company (FGIC) had been downgraded to below investment grade rating by two rating agencies, resulting in an increased interest rate on the New Bonds and termination of the Standby Bond Purchase Agreement. On July 7, 2008 the Ballet received proceeds from a short term loan of \$44,000,000 with an expiration date of August 15, 2008 to provide liquidity to purchase the New Bonds tendered by the bondholders. The Ballet expects to refinance the short term loan on a long term basis with the California Infrastructure and Economic Development Bank, Variable Rate Revenue Bonds, Series 2008 in 2008.

As a result of the FGIC downgrade and the intent to repurchase and cancel the New Bonds, the Ballet has written off the unamortized value of the FGIC insurance policy of \$1,107,749 and the remaining bond issuance costs of \$565,106 as of June 30, 2008.

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