

San Francisco Ballet Association

Consolidated Financial Statements
for the Year Ended June 30, 2008, and
Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated statement of financial position of the San Francisco Ballet Association (the "Ballet") as of June 30, 2008, and the related consolidated statement 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 2007 consolidated financial statements and, in our report dated October 31, 2007 (July 23, 2008, as to Note 13), 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, 2008, 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, 2008

SAN FRANCISCO BALLET ASSOCIATION

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2008

(With summarized financial information as of June 30, 2007)

	2008	2007
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 6,325,558	\$ 6,445,755
ACCOUNTS RECEIVABLE	85,929	325,395
PREPAID EXPENSES AND DEPOSITS	1,409,466	1,545,880
PLEDGES RECEIVABLE — Net	12,940,461	10,490,222
RECEIVABLES FROM SPLIT INTEREST AGREEMENTS — Net	6,120,374	4,875,918
ASSET HELD FOR SALE	182,750	
OTHER ASSETS	776,064	323,188
RESTRICTED CASH	8,743,693	16,399,505
BOND ISSUANCE COSTS — Net	1,500	1,672,855
PROPERTY AND EQUIPMENT — Net	32,908,089	29,968,126
ENDOWMENT INVESTMENTS	<u>87,451,612</u>	<u>88,420,185</u>
TOTAL	<u>\$ 156,945,496</u>	<u>\$ 160,467,029</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 4,696,250	\$ 4,036,277
Deferred compensation and postretirement benefit obligation	408,729	
Capital lease obligation		3,031,413
Deferred performance and school revenue	4,355,743	3,500,998
Gift annuity payment liability	254,146	
Interest rate swap liability	1,950,545	120,733
Bonds payable	<u>44,000,000</u>	<u>44,000,000</u>
Total liabilities	<u>55,665,413</u>	<u>54,689,421</u>
NET ASSETS:		
Unrestricted	28,119,432	38,187,724
Temporarily restricted	17,765,226	18,718,009
Permanently restricted	<u>55,395,425</u>	<u>48,871,875</u>
Total net assets	<u>101,280,083</u>	<u>105,777,608</u>
TOTAL	<u>\$ 156,945,496</u>	<u>\$ 160,467,029</u>

See notes to consolidated financial statements.

SAN FRANCISCO BALLET ASSOCIATION

CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS YEAR ENDED JUNE 30, 2008

(With summarized financial information for the year ended June 30, 2007)

	2008			2007 Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted		Total
OPERATING REVENUES:					
San Francisco performance	\$ 15,999,047	\$ -	\$ -	\$ 15,999,047	\$ 14,776,227
Touring	42,000			42,000	291,436
School and student housing	1,591,292			1,591,292	1,433,600
Postage and handling fees	421,674			421,674	402,402
Sales and rentals — net	211,279			211,279	215,506
Endowment transfers to operations	10,440,373			10,440,373	5,971,628
Dividend and interest income	635,900			635,900	1,228,715
Other income	116,812			116,812	60,102
Total operating revenues	29,458,377	-	-	29,458,377	24,379,616
OPERATING EXPENSES:					
Program services:					
Ballet production	27,350,481			27,350,481	23,362,642
Touring	65,178			65,178	1,070,846
School and student housing	4,456,774			4,456,774	3,530,538
Education and outreach	578,040			578,040	444,877
Total program services	32,450,473	-	-	32,450,473	28,408,903
Support services:					
Marketing, publicity, and audience development	5,463,488			5,463,488	3,883,286
General and administrative	4,224,032			4,224,032	4,362,059
Fundraising	2,347,369			2,347,369	1,921,658
Total support services	12,034,889	-	-	12,034,889	10,167,003
Net realized and unrealized losses on interest rate swap	2,081,646			2,081,646	249,469
Total operating expenses	46,567,008	-	-	46,567,008	38,825,375
Operating revenues less operating expenses	(17,108,631)	-	-	(17,108,631)	(14,445,759)
CONTRIBUTIONS IN SUPPORT OF OPERATIONS:					
Contributions	10,735,258	5,416,319		16,151,577	15,472,566
Special events and auxiliary activities — net	2,299,170			2,299,170	1,483,936
Net assets released from restrictions	4,341,458	(4,341,458)		-	-
Total contributions in support of operations	17,375,886	1,074,861	-	18,450,747	16,956,502
CHANGE IN NET ASSETS FROM OPERATIONS	267,255	1,074,861	-	1,342,116	2,510,743
ENDOWMENT:					
Contributions	2,111,477	44,805	7,607,103	9,763,385	11,490,657
Endowment management and expenses	(1,860,314)			(1,860,314)	(1,289,421)
Investment returns	(1,004,856)	(1,213,918)	(1,033,553)	(3,252,327)	12,197,312
Endowment transfers to operations	(10,440,373)			(10,440,373)	(5,971,628)
Write-off of pledges receivable	(12)		(50,000)	(50,012)	(60,000)
Net assets released from restrictions	858,531	(858,531)		-	-
Change in net assets from endowment	(10,335,547)	(2,027,644)	6,523,550	(5,839,641)	16,366,920
INCREASE (DECREASE) IN NET ASSETS	(10,068,292)	(952,783)	6,523,550	(4,497,525)	18,877,663
NET ASSETS — Beginning of year	38,187,724	18,718,009	48,871,875	105,777,608	86,899,945
NET ASSETS — End of year	\$ 28,119,432	\$ 17,765,226	\$ 55,395,425	\$ 101,280,083	\$ 105,777,608

See notes to consolidated financial statements.

SAN FRANCISCO BALLET ASSOCIATION

CONSOLIDATED STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2008

(With summarized financial information for the year ended June 30, 2007)

	2008	2007
OPERATING ACTIVITIES:		
(Decrease) increase in net assets	\$ (4,497,525)	\$ 18,877,663
Adjustments to reconcile (decrease) increase in net assets to net cash provided by (used in) operating activities:		
Permanently restricted contributions received	(3,815,850)	(9,008,826)
Depreciation	1,704,410	1,579,053
Impairments of long-lived assets	228,697	
Loss on asset disposals	69,733	
Amortization of bond issuance costs	57,520	53,952
Write-off of bond issuance costs	1,615,335	381,214
Net realized and unrealized losses (gains) on marketable investments	10,767,761	(7,795,481)
Limited partnership investment net gains	(5,204,278)	(2,026,906)
Change in allowance for doubtful pledges receivable	(14,795)	(71,931)
Change in discount of pledges receivable	(117,625)	90,702
Change in interest rate swap mark-to-market	1,829,812	120,733
Settlement of interest rate swap liability		(52,000)
Investment income restricted for long-term purposes	(467,606)	(877,522)
Net effect of changes in:		
Accounts receivable	239,466	(16,081)
Prepaid expenses and deposits	136,414	(507,699)
Pledges receivable	(3,255,553)	(3,364,090)
Receivables from split interest agreements	(1,244,456)	(180,701)
Other assets	(166,226)	(23,188)
Accounts payable and accrued expenses	659,973	893,596
Gift annuity payment liability	254,146	
Deferred compensation and postretirement benefit obligation	408,728	
Deferred performance and school revenue	854,745	560,797
Net cash provided by (used in) operating activities	<u>42,826</u>	<u>(1,366,715)</u>
INVESTING ACTIVITIES:		
Purchases of endowment investments	(26,116,675)	(23,892,971)
Proceeds from sales of endowment investments	21,521,765	15,021,468
Purchases of restricted cash		(42,578,252)
Uses of restricted cash	8,123,418	27,619,197
Expenditures for acquisitions of property and equipment	(7,568,577)	(5,300,792)
Net cash used in investing activities	<u>(4,040,069)</u>	<u>(29,131,350)</u>
FINANCING ACTIVITIES:		
Permanently restricted contributions received	3,815,850	9,008,826
Permanently restricted contributions received from sale of long-lived asset	230,000	
Principal payment on capital lease obligation	(167,304)	(121,031)
Repayment of line of credit		(1,368,158)
Bond proceeds received		44,000,000
Bonds refunded		(19,540,000)
Payment of bond issuance costs	(1,500)	(1,725,581)
Net cash provided by financing activities	<u>3,877,046</u>	<u>30,254,056</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(120,197)	(244,009)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>6,445,755</u>	<u>6,689,764</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 6,325,558</u>	<u>\$ 6,445,755</u>
SUPPLEMENTAL DISCLOSURES:		
Property acquired under capital lease	<u>\$ -</u>	<u>\$ 3,152,444</u>
Termination of capital lease	<u>\$ (2,864,109)</u>	<u>\$ -</u>
Contributed real estate in payment of pledge	<u>\$ 937,734</u>	<u>\$ -</u>
Cash paid during the year for interest	<u>\$ 2,228,224</u>	<u>\$ 1,576,597</u>

See notes to consolidated financial statements.

SAN FRANCISCO BALLET ASSOCIATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2008

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 current roster of eighty-one dancers, the Association has enjoyed a long and rich tradition of artistic “firsts” since its founding in 1933. 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, including certificates of deposit, with remaining maturities 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 and Gift Annuity Payment Liability — Receivables from split interest agreements represent the Ballet’s irrevocable remainder interests in a pooled income fund and various trusts primarily held by third-party trustees. The pooled income fund and trusts 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. Trusts contributed by donors under charitable gift annuity agreements and controlled by the Ballet are recognized at estimated fair value with a corresponding liability to beneficiaries of the annuity agreements. Such liability is calculated as the present value of the estimated future cash flows to be distributed to the income beneficiaries over their expected lives. In determining the fair value, the Ballet considers single or joint life expectancy from the 1983 Group Mortality Table and the RP-2000 Combined Healthy 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.

Asset Held for Sale — Asset held for sale consists primarily of donated real estate being actively marketed for sale at estimated fair value less selling costs. An impairment loss of approximately \$44,000 was recognized on this property at June 30, 2008, and is reflected in endowment management and expenses in the accompanying consolidated statement of activities and changes in net assets. Estimated fair value less selling costs was determined based on the actual close of escrow on the property on August 1, 2008.

Other Assets — Other assets in 2008 consists primarily of capitalized costs associated with the taping of *Nutcracker* in December 2007 for media distribution. These costs will be amortized in the period of contracted public television broadcast, theatrical release, and other distribution including home video/DVD and television distribution.

In addition on August 31, 2007, four condominium units in West Sacramento, California were donated to the Foundation in fulfillment of a pledge made the previous fiscal year. Of the four units, one had been sold, one is being held for sale, and two are included in other assets as of June 30, 2008.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The above donated real estate assets were considered impaired as of June 30, 2008 based on independent appraisals and sales of like properties. An impairment loss of approximately \$185,000 related to the donated assets remaining in other assets at June 30, 2008 is reflected in endowment management and expenses in the accompanying consolidated statement of activities and changes in net assets.

Other assets in 2007 consist 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.

Bond Issuance Costs — Bond issuance costs are being amortized over the term of the related bonds payable. At June 30, 2008, the remaining bond issuance costs for the Series 2006 Bonds were considered fully impaired and were written off.

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 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 production of *Nutcracker*, including the costs for sets, costumes, staging, and choreography, completed in 2005 and updated in 2007, is being depreciated on a straight-line basis over 15 years beginning in 2005.

Buildings and improvements included a capital lease for a warehouse of approximately \$3,150,000 as of June 30, 2007, which was the present value at the beginning of the lease term of the aggregate future minimum lease payments. The amortization of such assets was included in depreciation expense until the Ballet purchased the warehouse, thereby terminating the capital lease, in March 2008.

Endowment Investments — Endowment investments consist of equity and fixed income investments, limited partnership investments, 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 general partner of the limited partnerships. 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, 2008, primarily consists of advance ticket sales for performances scheduled in the Ballet's 2009 repertory season, which opens in January 2009, as well as advance tuition payments for school classes to be conducted in the year ending June 30, 2009.

Deferred Compensation and Postretirement Benefit Obligation — The Ballet's deferred compensation and postretirement benefit obligation arises from an individual contract with provisions for postretirement health benefits and salary continuance. In determining the fair value of the salary continuance, the Ballet considers the present value of expected future cash commitments. In determining the fair value of the postretirement health benefits, the Ballet considers the RP-2000 Combined Healthy Mortality Table, makes assumptions about future increases in health care premiums, and employs a discount rate which produces the same present value of benefits as a weighted average of yield rates on high-quality noncallable bonds. 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.

Derivative Instrument — The Ballet has an interest rate swap agreement (the "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 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. Unrestricted net assets in the Foundation include accumulated net investment returns and gifts whose principal is unrestricted and available for use by the Ballet. The Foundation's Board of Directors determines on an annual basis how much will be transferred from the Foundation's unrestricted net assets to the Association through a supplemental endowment transfer, with consideration given to the Association's unrestricted operating returns and the Foundation's accumulated net investment returns. The Ballet's intermediate measure of operations, change in net assets from operations, includes such transfer.

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 \$636,100 for the year ended June 30, 2008. Sales and rentals are also reduced by sales and use taxes remitted to government agencies.

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, 2008.

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, 2008, the value of contributed services recognized as revenues in the accompanying consolidated financial statements was approximately \$574,000 and consisted primarily of donated legal, investment advisory and design services, and travel vouchers. Of this amount, \$363,000 primarily 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 BRAVO (Ballet Resource and Volunteer Organization). 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 \$2,126,100 for the year ended June 30, 2008, including donated goods and services of approximately \$197,000.

Functional Expense Allocations — Expenses, such as depreciation, interest expense on bonds payable, write-off of bond issuance costs, 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 74% (484 employees) of the Ballet’s employees are covered by collective bargaining agreements. Of these employees, four active employees are covered under an agreement that expired on June 30, 2008. The renewal of this agreement was ratified by both parties as of October 2, 2008. Additionally, 232 employees are covered under agreements that will expire on June 30, 2009. Of this number, 105 dancers and stage managers are covered under the American Guild of Musical Artists agreement and 127 stage crew employees are covered under the International Alliance of Theatrical Stage Employees, Local 16 agreement. Negotiations on both contracts are expected to begin prior to contract expiration.

Income Tax Status — The Association has been classified as a publicly supported, tax-exempt organization under Section 501(c) (3) of the Internal Revenue Code, and is exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d). The Foundation has also been classified as a publicly supported, tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, and is 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 and liabilities 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 and liabilities 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 Deposit Insurance Corporation limits. The Ballet’s investments have been placed with major counterparties. The Ballet closely monitors these investments and its accounts and pledges receivable and has not experienced significant credit losses. The following endowment investments exceed 5% of the fair market value of total endowment investments at June 30, 2008:

Cash and cash equivalents held for investment	6 %
Dodge & Cox Income Fund	16
Dodge & Cox International Fund	12
Daedalus Partners, LLP	20

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 and liabilities valuation, fair value of assets held for sale, depreciable lives of property and equipment, fair value of endowment investments, postretirement benefits liabilities, 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, 2007, from which the summarized information was derived.

2. PLEDGES RECEIVABLE

Pledges receivable at June 30, 2008, are due as follows:

2009	\$ 7,662,348
2010 through 2014	<u>5,611,521</u>
Total pledges receivable	13,273,869
Less allowance for doubtful pledges receivable	(48,805)
Less discount for amounts expected to be collected after June 30, 2009	<u>(284,603)</u>
Pledges receivable — net	<u>\$ 12,940,461</u>

As of June 30, 2008, undiscounted pledges receivable include approximately \$6,869,000 due from members of the Association’s Board of Trustees and of the Foundation’s Board of Directors.

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) earnings on permanently restricted investments that are also permanently restricted, (3) temporarily restricted investments from the reinvested net income of endowment investments whose earnings have been restricted by donors for specific purposes, and (4) 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, 2008, 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, 2005, 2006, and 2007. In addition to the Operating Transfer of approximately \$3,724,000, the Foundation’s Board of Directors also approved a supplemental endowment transfer of 9% applied to the average of the estimated fair value of the total endowment investments as of March 31, 2005, 2006, and 2007, for the year ended June 30, 2008, which is approximately \$6,716,000. The amount of the supplemental transfer is at the discretion of the Foundation’s Board of Directors. See Note 1, Unrestricted Net Assets.

Endowment investments consist of the following at June 30, 2008, at estimated fair value:

Equity investments	\$ 38,901,880
Fixed income investments	14,343,473
Limited partnership investment — marketable	3,721,338
Limited partnership investments — nonmarketable	24,803,123
Cash and cash equivalents held for investment	<u>5,681,798</u>
 Total endowment investments	 <u>\$ 87,451,612</u>

The investment return from the endowment investments for the year ended June 30, 2008, consists of the following:

Net realized and unrealized losses on marketable instruments	\$(10,767,761)
Limited partnership investment net unrealized gains — marketable	131,592
Limited partnership investment net unrealized gains — nonmarketable	5,072,686
Dividends and interest	<u>2,311,156</u>
 Total return on endowment investments	 <u>\$ (3,252,327)</u>

A member of the Foundation's Board of Directors is a General Partner of a nonmarketable limited partnership investment valued at \$17,175,000 at June 30, 2008. A member of the Association's Board of Trustees is the Chairman and Chief Executive Officer of the Foundation's investment custodian. That custodian operates as a division of a larger bank, of which another member of the Association's Board of Trustees is an employee. These transactions were subject to customary arrangements regarding fees and, for the limited partnership, allocation of investment gains.

The estimated fair value of endowment investments at October 31, 2008 is approximately \$72.5 million.

4. PROPERTY AND EQUIPMENT

The Ballet's property and equipment at June 30, 2008, is as follows:

Land	\$ 4,519,388
Buildings and improvements	33,007,362
Furniture and equipment	3,997,014
Capitalized sets and costumes	8,798,851
Construction in progress	<u>50,740</u>
 Total property and equipment	 50,373,355
 Accumulated depreciation	 <u>(17,465,266)</u>
 Property and equipment — net	 <u>\$ 32,908,089</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 June 30, 2009. The Ballet had no outstanding borrowings under the line of credit as of June 30, 2008.

As discussed in Notes 6 and 14, subsequent to June 30, 2008, the Ballet entered into an interest only \$44,000,000 nonrevolving term loan (the "Short-Term Loan") with the same bank, guaranteed by the Foundation, in conjunction with the refinancing of the Series 2006 Bonds. The Short-Term Loan had an expiration date of August 15, 2008, and was paid off on August 1, 2008. Interest on the Short-Term Loan was charged at the prime rate plus 1%.

A member of the Association's Board of Trustees is the Chairman and Chief Executive Officer of the bank with which the Ballet has its credit facilities. That bank operates as a division of a larger bank, of which another member of the Association's Board of Trustees is an employee. For purposes of the Short-Term Loan, both members recused themselves from the Ballet's and the bank's approval process. These transactions were subject to customary arrangements regarding fees.

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 "Series 2006 Bonds") and refunded the \$19,540,000 in Revenue Bonds, Series 2002 (the "Series 2002 Bonds"). The Series 2006 Bonds bore interest at a variable rate reset daily, matured on various dates from July 1, 2027 through July 1, 2036, were an unsecured obligation of the Ballet, were guaranteed by the Foundation, and were insured by the Financial Guaranty Insurance Company (FGIC).

At June 30, 2008, the fair market value of the Series 2006 Bonds was quoted at \$44,000,000. Accumulated amortization as of June 30, 2008, related to the bond issuance costs of the Series 2006 Bonds was \$57,520. Interest payments were payable and due on the first of each month. Interest expense related to bonds payable for the year ended June 30, 2008, was approximately \$2,049,000. In connection with the Series 2006 Bonds, the Ballet was required to be in compliance with certain financial covenants at June 30, 2008.

The remaining proceeds from the Series 2006 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 Series 2002 Bonds, the proceeds from the Series 2006 Bonds were used for the purchase and renovation of a warehouse and a student residence, certain technology hardware upgrades, reimbursement of costs for projects undertaken in connection with the Series 2002 Bonds, construction of ballet sets and costumes, the payment of interest and fees, and costs incurred in connection with the issuance of the Series 2006 Bonds and will be used for a new full-length ballet production and new theatrical equipment.

Concurrent with the issuance of the Series 2006 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 Series 2006 Bonds. 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 Series 2006 Bonds was \$(1,951,000) at June 30, 2008, and is included in interest rate swap liability in the accompanying consolidated statement of financial position. Payments made to the counterparty of the Swap Agreement were approximately \$252,000 during the year ended June 30, 2008. The Swap Agreement contains certain collateral requirements based on the credit rating of the Ballet and of FGIC combined with the current fair market value of the Swap Agreement. As of June 30, 2008, the Ballet had not been required to post collateral on the Swap Agreement.

As of June 20, 2008, the Series 2006 Bonds insurer, FGIC, had been downgraded to below investment grade rating by two rating agencies, resulting in termination of the Standby Bond Purchase Agreement and an increased interest rate on the Series 2006 Bonds. On June 25, 2008, the remarketing agent set the

variable rate on the Series 2006 Bonds at 12%, the maximum allowable rate on the Series 2006 Bonds as determined in the Indenture, and that rate remained in effect at June 30, 2008. On July 7, 2008, the Ballet received proceeds from the Short-Term Loan of \$44,000,000 to provide liquidity to purchase the Series 2006 Bonds tendered by the bondholders, and consequently on July 9, 2008 the variable rate decreased to 2%. The Ballet refinanced the Short-Term Loan on a long-term basis with the California Infrastructure and Economic Development Bank, Variable Rate Revenue Bonds, Series 2008 (the “Series 2008 Bonds”) on August 1, 2008, as further discussed in Note 14.

As a result of the FGIC downgrade and the Ballet’s intent to repurchase and cancel the Series 2006 Bonds, the Ballet has written off the unamortized value of the FGIC insurance policy of \$1,069,660 and the remaining bond issuance costs of \$545,675 related to the Series 2006 Bonds as of June 30, 2008. The consolidated statement of financial position reflects bonds issuance costs of \$1,500 at June 30, 2008, which reflects prepaid costs of the Series 2008 Bonds.

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

As of June 30, 2008, temporarily restricted net assets were available for the following purposes:

For use in ensuing fiscal years	\$ 5,728,025
Property and equipment	4,922,556
Touring (including 75th Anniversary contributions)	2,307,990
75th anniversary — other	1,606,965
New media	900,000
New ballet production	830,312
Ballet school support	995,112
Education and outreach, including dancer wellness and career transition	<u>474,266</u>
Total temporarily restricted net assets	<u>\$17,765,226</u>

Net assets were released from donor restrictions during the year ended June 30, 2008, by incurring expenses satisfying the restricted purposes specified by donors as follows:

Due to the expiration of time	\$2,648,850
75th Anniversary	1,887,519
Ballet school support	330,000
Property and equipment	312,599
Education and outreach, including dancer wellness and career transition	<u>21,021</u>
Total net assets released from restrictions	<u>\$5,199,989</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, 2008, of approximately \$1,716,000, is included in accounts payable and accrued expenses in the accompanying consolidated statement of financial position. At June 30, 2008, the Ballet had unused letters of credit totaling \$2,380,800, 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. Accrued contributions approximated \$383,000 for the year ended June 30, 2008, of which contributions of \$353,000 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 \$2,304,000 for the year ended June 30, 2008.

The Ballet has an agreement with a key employee to provide postretirement salary continuance and employee and spousal health benefits for a fixed period of time dependent on the number of years served under the agreement and on the absence of certain types of postretirement employment and benefits available to the employee. The fair value of the salary continuance of \$301,000 has been calculated based on the net present value of the expected payments. The total present value at June 30, 2008 of the future health benefits, or the expected postretirement benefit obligation for health, is approximately \$135,000. The accumulated postretirement benefit obligation of the future health benefits, as of June 30, 2008 is \$107,254. The FASB Statement No. 106 cost for the year ending June 30, 2009 for future health benefits will be \$14,000. FASB Statement No. 106 cost for the health benefits for the subsequent four years is estimated to be approximately \$15,000, \$16,000, \$16,000, and \$17,000, respectively.

The following table sets forth the health benefits agreement’s benefit obligations, fair value of plan assets, and status as of June 30, 2008, which liability is included in the consolidated statement of financial position.

Benefit obligation	\$ 107,254
Fair value of plan assets	<u>-</u>
Unfunded status — end of year	<u>\$ (107,254)</u>

Amounts recognized for health benefits in unrestricted net assets consist of unrecognized prior service costs of \$107,254 as of June 30, 2008. There was no periodic net benefit cost for the year ended June 30, 2008. The weighted average assumption used to determine benefit obligations at June 30, 2008 was 6.5%.

Assumed health care trend rates have significant effect on the amounts reported for health care premiums. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect on the health care component of the accumulated postretirement benefit obligation	<u>\$ 8,669</u>	<u>\$ (7,979)</u>

For measurement purposes, an 8.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended June 30, 2009. The rate was assumed to decrease gradually to 5.5% through the year ending June 30, 2019 and remain at that level thereafter.

No benefits are expected to be paid from the postretirement benefit plan in each year ended June 30, 2009 to June 30, 2013. The aggregate benefits expected to be paid in the five years from 2014 to 2018 are approximately \$58,000. The expected benefits are based on the same assumptions used to measure the Ballet’s benefit obligation at June 30, 2008 and include future employee service.

10. LEASE COMMITMENTS

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

Years Ending June 30	
2009	\$ 61,000
2010	56,000
2011	<u>34,000</u>
Total	<u>\$ 151,000</u>

Rent expense from operating leases approximated \$350,000 for the year ended June 30, 2008.

11. INCOME TAXES

The Ballet adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* (FIN No. 48), effective July 1, 2007. 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. Ballet management believes that no liabilities are required to accrue for uncertain tax positions in connection with the adoption of FIN No. 48.

12. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement of Financial Accounting Standards (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 ending June 30, 2009.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FASB Statement No. 159 permits the Ballet to choose, at specified election dates, eligible items to measure at fair value (the "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. Under FASB Statement No. 159, the decision to measure items at fair value is made at specified election dates on an irrevocable instrument-by-instrument basis. If the Ballet elects to adopt the Fair Value Option, it would be required to recognize changes in fair value in earnings and to expense up-front cost and fees associated with the item for which the Fair Value Option is elected. The Ballet did not elect the Fair Value Option provided for in this standard for any instruments it held on July 1, 2008.

In August 2008, the FASB issued FASB Staff Position (FSP) No. FAS 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*. The FSP provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). It also establishes disclosure requirements for all not-for-profit organizations regarding both donor-restricted and board-designated endowment funds. The provisions of the FSP are effective for fiscal years ending after December 15, 2008. The Ballet is currently evaluating the impact of adopting FSP No. FAS 117-1 for its fiscal year ending June 30, 2009.

13. 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.

14. SUBSEQUENT EVENT — BOND REFUNDING

On August 1, 2008, the Ballet entered into an agreement to refund the Series 2006 Bonds with the issuance of \$44,900,000 in Series 2008 Bonds, as discussed in Note 6. The Series 2008 Bonds bear interest at a variable rate (1.75% at August 1, 2008), mature on various dates from July 1, 2029 through July 1, 2038, are secured by Gross Revenues of the Ballet as defined in the Letter of Credit Reimbursement Agreement with Allied Irish Bank, P.L.C. (AIB), and are guaranteed by the Foundation, as defined in the Guaranty Agreement with the Foundation and the California Infrastructure and Economic Development Bank and The Bank of New York Mellon Trust Company, as Trustee. Interest payments will be due and payable on the first of each month. As guarantor, the Foundation guarantees the full and prompt payment and performance when due, whether by acceleration or otherwise, and at all times thereafter, of all obligations of the Association to AIB under the Series and guarantees to the California Infrastructure and Economic Development Bank and The Bank of New York Mellon Trust Company, as Trustee, (a) the principal of and redemption premium, if any, on the 2008 Bonds when and as the same shall become due (whether at maturity, by acceleration, call for redemption or otherwise); (b) the interest on the 2008 Bonds when and as the same shall become due; (c) the purchase price of the 2008 Bonds tendered or deemed tendered for purchase pursuant to the Indenture; and (d) all amounts due or to become due under the Loan Agreement.

A portion of the proceeds of the Series 2008 Bonds were placed into an escrow account, which had sufficient amounts to repay the Ballet's Short-Term Loan. As a result of the refinancing, all of the refunded Series 2006 Bonds have been legally defeased and no longer represent obligations of the Ballet.

The existing Swap Agreement remains in place at the same notional amount, interest rate, term, and maturity date as discussed in Note 6, but is no longer insured by FGIC. An amendment to the Swap Agreement dated July 9, 2008 removed FGIC from the collateral requirements and increased the decline in the fair market value in the Swap Agreement required before either the Ballet or the counterparty must post collateral.

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