HOUSTON BALLET FOUNDATION
AND AFFILIATE

COMBINED FINANCIAL STATEMENTS

JUNE 30, 2013

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED FINANCIAL STATEMENTS
JUNE 30, 2013

C O N T E N T S

UHY LLP
Certified Public Accountants

2929 Allen Parkway, 20th Floor
Houston, TX 77019-7100
Phone 713-561-6500
Fax 713-968-7128
Web www.uhy-us.com

Independent Auditor's Report

To the Board of Trustees of
Houston Ballet Foundation
Houston, Texas

We have audited the accompanying combined financial statements of Houston Ballet Foundation and its affiliate, Houston Ballet Guild (collectively, the "Foundation"), which comprise the combined statement of financial position as of June 30, 2013, and the related combined statements of activities, cash flows and functional activities for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these combined financial statements based on our audit. 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2013, and the combined results of their activities and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

UHY LLP

Houston, Texas
September 16, 2013

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED STATEMENT OF FINANCIAL POSITION
JUNE 30, 2013

	General Fund	Endowment Fund	Plant Fund	Total
ASSETS				
Cash and cash equivalents	$ 4,219,570	$ 158,927	$ 1,296,609	$ 5,675,106
Restricted cash	-	6,000,000	-	6,000,000
Pledges receivable	415,682	35,000	-	450,682
Other receivables	52,542	3	-	52,545
Prepaid and deferred production expenses	631,205	-	-	631,205
Investments, at fair value	456,276	53,888,822	-	54,345,098
Land, building, equipment and costumes and sets, net	595,554	-	47,593,641	48,189,195
TOTAL ASSETS	$ 6,370,829	$ 60,082,752	$ 48,890,250	$ 115,343,831
LIABILITIES AND NET ASSETS				
LIABILITIES				
Accounts payable and accrued liabilities	$ 1,035,844	$ -	$ -	$ 1,035,844
Deferred revenue	4,299,912	-	-	4,299,912
Due to (from) other funds	(1,069,141)	58,321	1,010,820	-
Note payable	-	-	5,500,000	5,500,000
TOTAL LIABILITIES	4,266,615	58,321	6,510,820	10,835,756
COMMITMENTS AND CONTINGENCIES				
NET ASSETS				
Unrestricted	934,860	28,114,943	42,379,430	71,429,233
Temporarily restricted	1,169,354	-	-	1,169,354
Permanently restricted	-	31,909,488	-	31,909,488
TOTAL NET ASSETS	2,104,214	60,024,431	42,379,430	104,508,075
TOTAL LIABILITIES AND NET ASSETS	$ 6,370,829	$ 60,082,752	$ 48,890,250	$ 115,343,831

See accompanying notes to combined financial statements.

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING INCOME				
Performance	$ 8,539,827	$ -	$ -	$ 8,539,827
Tuition	2,203,483	-	-	2,203,483
Special events	7,168,215	-	-	7,168,215
Investment	1,223,378	-	-	1,223,378
Other	904,088	-	-	904,088
TOTAL OPERATING INCOME	20,038,991	-	-	20,038,991
OPERATING EXPENSES				
Production and company	15,759,923	-	-	15,759,923
Ballet academy	2,605,472	-	-	2,605,472
Fund-raising	878,298	-	-	878,298
General and administrative	1,813,689	-	-	1,813,689
Special events	2,857,719	-	-	2,857,719
TOTAL OPERATING EXPENSES	23,915,101	-	-	23,915,101
DECREASE IN NET ASSETS FROM OPERATING ACTIVITIES BEFORE PUBLIC AND PRIVATE SUPPORT, RELEASES FROM RESTRICTIONS AND TRANSFERS	(3,876,110)	-	-	(3,876,110)
PUBLIC AND PRIVATE SUPPORT CONTRIBUTIONS	3,288,300	1,169,354	-	4,457,654
INCREASE (DECREASE) IN NET ASSETS FROM OPERATING ACTIVITIES BEFORE RELEASES FROM RESTRICTIONS AND TRANSFERS	(587,810)	1,169,354	-	581,544
NET ASSETS RELEASED FROM RESTRICTIONS	1,791,842	(1,791,842)	-	-
INCREASE (DECREASE) IN NET ASSETS FROM OPERATING ACTIVITIES BEFORE INTERFUND TRANSFERS	1,204,032	(622,488)	-	581,544
INTERFUND RECLASSIFICATION	(1,130,346)	-	-	(1,130,346)
INCREASE (DECREASE) IN NET ASSETS FROM OPERATING ACTIVITIES	73,686	(622,488)	-	(548,802)
ENDOWMENT ACTIVITIES				
Contributions	-	-	134,848	134,848
Net appreciation on investments	7,834,444	-	-	7,834,444
Investment expenses, net	(148,428)	-	449	(147,979)
Interfund reclassification	(750,000)	-	-	(750,000)
INCREASE IN NET ASSETS FROM ENDOWMENT ACTIVITIES	6,936,016	-	135,297	7,071,313

See accompanying notes to combined financial statements.

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED STATEMENT OF ACTIVITIES (Continued)
YEAR ENDED JUNE 30, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
PLANT ACTIVITIES				
Gain on disposal of land, building, equipment and costumes and sets, net	160,585	-	-	160,585
Contributions	2,936,649	-	-	2,936,649
Interest and other expense, net	(135,279)	-	-	(135,279)
Depreciation	(1,372,894)	-	-	(1,372,894)
Interfund reclassification	1,880,346	-	-	1,880,346
INCREASE IN NET ASSETS FROM PLANT ACTIVITIES	3,469,407	-	-	3,469,407
TOTAL INCREASE (DECREASE) IN NET ASSETS	10,479,109	(622,488)	135,297	9,991,918
NET ASSETS, beginning of year	60,950,124	1,791,842	31,774,191	94,516,157
NET ASSETS, end of year	$ 71,429,233	$ 1,169,354	$ 31,909,488	$ 104,508,075

See accompanying notes to combined financial statements.

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2013

	General Fund	Endowment Fund	Plant Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES				
Total increase (decrease) in net assets	$ (548,802)	$ 7,071,313	$ 3,469,407	$ 9,991,918
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:				
Net realized and unrealized gains on investments	(48,189)	(7,834,444)	-	(7,882,633)
Depreciation	-	-	1,372,894	1,372,894
Gain on disposal of land, building, equipment and costumes and sets	-	-	(160,585)	(160,585)
Changes in:				
Pledges receivable	111,134	-	(2,936,649)	(2,825,515)
Other receivables	41,338	-	-	41,338
Prepaid and deferred production expenses	324,885	-	-	324,885
Accounts payable and accrued liabilities	974,363	70,056	(886,443)	157,976
Deferred revenue	583,080	-	-	583,080
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	1,437,809	(693,075)	858,624	1,603,358
CASH FLOWS FROM INVESTING ACTIVITIES				
Capital expenditures	(595,554)	-	(236,854)	(832,408)
Increase in restricted cash	-	(6,000,000)	-	(6,000,000)
Purchase of investments	(106,539)	(7,636,052)	-	(7,742,591)
Proceeds from sales and maturities of investments	62,557	14,309,025	617,480	14,989,062
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(639,536)	672,973	380,626	414,063
CASH FLOWS FROM FINANCING ACTIVITIES				
Note payments	-	-	(2,988,580)	(2,988,580)
Gifts and donations restricted for long-term purposes	-	-	2,936,649	2,936,649
NET CASH USED IN FINANCING ACTIVITIES	-	-	(51,931)	(51,931)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	798,273	(20,102)	1,187,319	1,965,490
CASH AND CASH EQUIVALENTS, beginning of year	3,421,297	179,029	109,290	3,709,616
CASH AND CASH EQUIVALENTS, end of year	$ 4,219,570	$ 158,927	$ 1,296,609	$ 5,675,106
SUPPLEMENTAL DISCLOSURE				
Interest paid	$ -	$ -	$ 115,849	$ 115,849

See accompanying notes to combined financial statements.

HOUSTON BALLET FOUNDATION AND AFFILIATE
COMBINED STATEMENT OF FUNCTIONAL ACTIVITIES
YEAR ENDED JUNE 30, 2013

	Program Services		Support Services			
	Production and Company	Ballet Academy	General and Administrative	Fund-Raising	Special Events	Total
Advertising	$ 2,319,232	$ 135,168	$ -	$ 111,707	$ -	$ 2,566,107
Computer maintenance, software	9,701	19,401	9,700	-	-	38,802
Costumes, scenery and designers	716,366	-	-	-	-	716,366
Depreciation	343,224	686,447	343,223	-	-	1,372,894
Donor benefit expenses	-	-	-	-	2,857,719	2,857,719
Equipment rentals	779	1,557	777	-	-	3,113
Insurance	37,542	75,084	37,541	-	-	150,167
Interest expense	-	-	115,849	-	-	115,849
Investment expense	-	-	148,428	-	-	148,428
Music and royalties	136,487	-	-	-	-	136,487
Office supplies	14,240	3,749	39,129	4,128	-	61,246
Postage and handling	14,578	3,572	4,608	4,550	-	27,308
Printing	621,584	-	-	1,116	-	622,700
Professional fees	-	-	229,768	-	-	229,768
Repairs and maintenance	471,326	165,727	82,861	-	-	719,914
Salaries, payroll taxes and employee benefits	9,633,106	974,037	1,190,342	638,038	-	12,435,523
Scholarships	-	426,400	-	-	-	426,400
Shipping and freight	95,255	-	-	-	-	95,255
Shoes and tights	143,815	-	-	-	-	143,815
Special campaigns	-	-	-	7,311	-	7,311
Stage equipment and supplies	112,828	-	-	-	-	112,828
Stipends	-	123,245	-	-	-	123,245
Summer housing	-	283,958	-	-	-	283,958
Telephone and utilities	117,052	234,103	117,049	-	-	468,204
Theater costs	595,855	-	-	-	-	595,855
Ticket service, booking fees	323,793	-	-	-	-	323,793
Travel and entertainment	308,181	100,148	22,068	-	-	430,397
Miscellaneous	88,203	59,323	123,862	111,448	-	382,836
						-
	$ 16,103,147	$ 3,291,919	$ 2,465,205	$ 878,298	$ 2,857,719	$ 25,596,288

See accompanying notes to combined financial statements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The combined financial statements of Houston Ballet Foundation and its affiliate, the Houston Ballet Guild, (collectively, the "Foundation") have been prepared on the accrual basis of accounting. The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Significant accounting policies followed by the Foundation are described below.

Basis of Presentation: The Foundation's net assets and its revenue, expenses, gains and losses are classified within the statements based on the existence or absence of donor-imposed restrictions as permanently restricted, temporarily restricted or unrestricted.

Preproduction Expenses and Advance Ticket Sales: Program revenues and expenses are recognized in the program year to which they apply. Ticket sales and preproduction costs for future season's programs are recorded as deferred revenue and deferred production expenses, respectively.

Pledges Receivable: Pledges made by donors are initially considered to be temporarily restricted and become unrestricted upon satisfaction of such restriction, which is typically a stipulated time restriction or purpose restriction. Pledges receivable are primarily from large foundations and corporations.

Pledges receivable represent unconditional promises to give and are monitored by the Foundation for potential losses.

Pledges deemed uncollectible are written off against related revenue or contributions. The Foundation has determined, through review of its donors' pledge payment history, that no allowance for uncollectible amounts is necessary as of June 30, 2013.

Contributions: The Foundation accounts for contributions received, including unconditional promises to give, as revenue in the period received at their fair values. The Foundation also distinguishes between contributions that increase permanently restricted, temporarily restricted and unrestricted net assets. The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

Land, Building, Equipment and Costumes and Sets: Land, building, equipment and costumes and sets related to full-length productions are recorded at cost. Depreciation of building and equipment is provided over the estimated useful lives of the respective assets on a straight-line basis. Depreciation of costumes and sets related to full-length productions is provided on a straight-line basis over three years, beginning in the year the production is initially performed. Depreciation expense for the year ended June 30, 2013 totaled $1,372,894.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Production and Foundation Costs: Production costs for ballet performances include the salaries of performers, cost of costumes, stage sets, theater rental, orchestra fees and other related expenses. All such costume and stage set costs related to full-length productions are capitalized and depreciated as described above. All other production expenses such as the salaries of performers, theater rental and orchestra fees are expensed in the year of the performance.

Foundation costs include salaries and benefits for dancers, artistic staff and music staff, costs for guest artists and guest music conductors and other miscellaneous expenses.

Functional Expenses: Costs related to the operation and maintenance of the building, including depreciation, are allocated to program and supporting activities based upon the approximate square footage of utilized facilities.

Advertising: All costs of advertising that relate to the current year are expensed as incurred. Costs related to productions or events in the subsequent year are recorded as prepaid expense and are expensed at the time the performance or event takes place.

Cash Equivalents: For purposes of the combined statement of cash flows, the Foundation considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents.

Restricted Cash: The Foundation's restricted cash balance is related to the funding of a subscription agreement with a major capital investment firm. As of June 30, 2013, $6,000,000 was held by the investment firm and restricted for future funding in an investment vehicle, subject to the provisions of the subscription agreement. In July 2013, the funds were invested in the "Main Fund" of the investment vehicle and is managed by the investment firm subject to the provisions of a separate but related Main Fund Agreement.

Investments and Investment Income: The Foundation accounts for investments in equity securities with readily determinable fair market values and all investments in debt securities at fair market value with gains and losses included in the statement of activities.

Endowment funds, which consist primarily of marketable securities, are pooled for investment management purposes. Income from investments is allocated to each endowment based upon the relative market value and the type of endowment.

Investment income, including realized and unrealized gains or losses on investments, is recorded as unrestricted for all funds because there are no donor-imposed restrictions. For the year ended June 30, 2013, as stipulated by the Foundation's investment policy, up to 5.5% of the market value of endowment investments and cash may be used for general operating activities. Realized and unrealized gains or losses on endowment investments were reinvested and recorded in endowment activities on the combined statement of activities.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Donated Services and Materials: A substantial number of volunteers have donated time in connection with program services and administration of the Foundation. No value has been reflected in the financial statements for these services because the services would not typically be purchased if they had not been provided by donation. When outside services are donated to the Foundation and the services received (a) create or enhance non-financial assets or (b) require specialized skills and are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation, a contribution is recorded in the period received. Such contribution is valued at the estimated cost to the Foundation had the services and/or materials been purchased. The Foundation recorded $1,340,909 in the General Fund for donated services and materials during the year ended June 30, 2013, including $1,023,606 of donated services and materials for special events.

Non-Monetary Transactions: During the year ended June 30, 2013, $507,805 of Houston Ballet Foundation performance tickets were traded in exchange for marketing, public relations, production and development purposes. Such amounts are recorded as both performance income and operating expenses.

Concentrations of Credit Risk: The Foundation is subject to concentrations of credit risk relating primarily to cash, marketable securities and pledges receivable. The Foundation's cash and cash equivalent deposits are held in major financial institutions in excess of the federally insured limit. Marketable securities consist primarily of domestic corporate stocks, which could subject the Foundation to losses in the event of a general downturn in the stock market. The Foundation has reduced its risk relating to investment in corporate stocks through diversification into investments in a variety of industries. Pledges receivable represent unconditional promises to give and are monitored by the Foundation for potential losses.

Estimates: The preparation of the Foundation's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates.

Income Taxes: The Foundation is a nonprofit organization and has been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. For the year ended June 30, 2013, the Foundation had no unrelated business income, and no income tax is expected to be due and payable by the Foundation.

The Foundation follows current guidance in accounting for uncertainty in income taxes. This guidance clarifies the accounting for income taxes by prescribing the minimum recognition threshold an income tax position is required to meet before being recognized in the financial statements and applies to all income tax positions. Each income tax position is assessed using a two-step process. A determination is first made as to whether it is more likely than not that the income tax position will be sustained, based upon technical merits, upon examination by the taxing authorities. If the income tax position is expected to meet the more likely than not criteria, the benefit recorded in the financial statements equals the largest amount that is greater than 50% likely to be realized upon its ultimate settlement. The Foundation did not recognize any uncertain tax positions upon adoption of the guidance and had no uncertain tax positions as of June 30, 2013.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The income tax position taken by the Foundation, for any years open under the various statutes of limitations, is that the Foundation continues to be exempt from income taxes by virtue of being a nonprofit organization. Management believes this tax position meets the more-likely-than-not threshold and, accordingly, the tax benefit of this income tax position (no income tax liability) has been recognized for the years ended on or before June 30, 2013.

The Foundation will record income tax related interest and penalties, if applicable, as a component of the provision for income tax expense. However, there were no amounts recognized relating to interest and penalties in the statement of activities for the year ended June 30, 2013. The Foundation's federal exempt organization business tax returns (Form 990) for 2009 and later are subject to examination by the IRS.

NOTE B - FAIR VALUE DISCLOSURE

The Foundation follows current guidance on fair value measurements which defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements.

Current guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

> **Level 1 -** inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
>
> **Level 2 -** inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
>
> **Level 3 -** inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Foundation's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The following table presents information about the Foundation's assets measured at fair value on a recurring basis, and indicates the fair value hierarchy of the valuation techniques utilized by the Foundation to determine such fair value:

NOTE B - FAIR VALUE DISCLOSURE (Continued)

	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Items (Level 2)	Significant Unobservable Items (Level 3)	Balance at June 30, 2013
General Fund				
Corporate stocks and mutual funds	$ 456,276	$ -	$ -	$ 456,276
Endowment Fund				
Corporate stocks and mutual funds	53,888,822	-	-	53,888,822
TOTAL	$ 54,345,098	$ -	$ -	$ 54,345,098

NOTE C - INVESTMENTS

Investment returns for all funds are classified as unrestricted on the combined statement of activities. The components of investment returns for each fund for the year ended June 30, 2013 were as follows:

	General Fund	Endowment Fund	Plant Fund	Total
Interest and dividend income	$ 95,530	$ 1,077,852	$ 201	$ 1,173,583
Net realized gains (losses)	2,451	740,089	-	742,540
Net unrealized gains (losses)	47,994	7,094,355	-	7,142,349
	145,975	8,912,296	201	9,058,472
Amounts designated for general operating activities	(145,975)	(1,827,403)	-	(1,973,378)
Excess of amounts designated for general operating activities	$ -	$ 7,084,893	$ 201	$ 7,085,094

Total cumulative net unrealized gains on General Fund and Endowment Fund investments held at June 30, 2013 were $159,794 and $10,831,160, respectively.

NOTE D - LAND, BUILDING, EQUIPMENT AND COSTUMES AND SETS

The following components are included in land, building, equipment and costumes and sets at June 30, 2013:

	Estimated Useful Life	
Buildings and improvements	25-39 years	$ 39,179,634
Office furniture and equipment	5-15 years	3,154,227
Costumes and sets	3 years	5,010,654
		47,344,515
Less: accumulated depreciation		(9,440,052)
		37,904,463
Land	N/A	9,689,178
Costumes and sets-production in progress		595,554
		$ 48,189,195

NOTE E - SPECIAL EVENTS

The Houston Ballet Guild (the "Guild") is an affiliated, nonprofit organization that sponsors various fund-raising activities throughout the year for the benefit of the Foundation. The Guild's largest fund-raising events include operating the annual Nutcracker Market in November and hosting the Annual Ball. The revenues and expenses of the Guild are presented as special events on the combined statement of activities.

NOTE F - PLEDGES

The Foundation continues its pursuit of endowment funds to guarantee future financial security. Multi-year pledges receivable are recorded at present value on the date of the pledge for the amount of discounted cash flows using the prime rate at the date of pledge. The Foundation also receives pledges for annual operations, which are recorded in the General Fund.

As of June 30, 2013, pledges receivable were:

Less than one year	$ 170,678
One to five years	245,004
Greater than five years	35,000
	$ 450,682

NOTE G - ENDOWMENTS

The Foundation follows current guidance on net asset classification of endowments. This guidance clarifies the accounting for donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This guidance also requires additional disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

The State of Texas enacted UPMIFA on September 1, 2007, the provisions of which apply to endowment funds existing on or established after the date of enactment. The Foundation has adopted this guidance and determined that the majority of the Foundation's permanently restricted net assets meet the definition of endowment funds under UPMIFA. Based on the Foundation's interpretation of UPMIFA, the Foundation has reviewed all of its endowment funds and reclassification is not needed as of June 30, 2013.

Balances of the funds included in permanently restricted net assets at June 30, 2013 were as follows:

Endowment funds:	
Use of income is unrestricted	$ 31,767,148
Use of income is restricted for:	
Dancer Career Transition - Artists Reserve Fund	142,340
Total endowment funds	$ 31,909,488

Endowment funds with unrestricted use of income are as follows:

- *The Endowed Artistic Positions Fund* - assists Houston Ballet in attracting talented artists.
- *The Fayez Sarofim & Co. Touring Fund* - sponsors Houston Ballet's domestic and international tours.
- *The Carolyn Lee and Frederick Adrian Lee Production Fund* - supports the creation of new productions and the restoration of existing works.
- *The Margaret Wiess Elkins Young Artist Fund* - trains talented young people for careers in dance.
- *The AIG American General/AIG VALIC Education and Community Outreach Programs Fund* - helps Houston Ballet reach a broad population of all ages and economic levels.
- *The Billie Bath Perlman Scholarship Fund; The Roy M. Huffington Scholarship Fund; The Ben Stevenson Scholarship Fund; The Winifred Wallace Scholarship Fund; The Anita Borges Stude Scholarship Fund* - each provides the full cost for training one Houston Ballet II dancer each year.

The Foundation's endowments consist of funds established for a variety of purposes. Its endowments include donor-restricted funds. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

NOTE G - ENDOWMENTS (Continued)

The Foundation's Board has interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations 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 Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: the duration and preservation of the fund, the purposes of the Foundation 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 Foundation, and the investment policies of the Foundation.

The endowment net asset composition by type of fund as of June 30, 2013 was:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ 23,141,609	$ -	$ 31,909,488	$ 55,051,097
Board-designated endowment funds	4,973,334	-	-	4,973,334
	$ 28,114,943	$ -	$ 31,909,488	$ 60,024,431

The changes in endowment net assets for the year ended June 30, 2013 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 21,178,927	$ -	$ 31,774,191	$ 52,953,118
Investment return:				
Investment income	1,077,403	-	449	1,077,852
Net realized and unrealized appreciation	7,834,444	-	-	7,834,444
Total investment return	8,911,847	-	449	8,912,296
Contributions	-	-	134,848	134,848
Investment expenses	(148,428)	-	-	(148,428)
Appropriation of endowment assets for expenditures	(1,827,403)	-	-	(1,827,403)
Endowment net assets, end of year	$ 28,114,943	$ -	$ 31,909,488	$ 60,024,431

NOTE G - ENDOWMENTS (Continued)

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 UPMIFA requires the Foundation to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, there were no deficiencies of this nature as of June 30, 2013.

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Foundation must hold in perpetuity or for a donor-specified period.

NOTE H - NOTE PAYABLE

On July 22, 2010, the Foundation entered into a tax-exempt financing agreement ("Note") with Sanger Cultural Education Facilities Finance Corporation ("Sanger") to borrow up to $20,000,000 to complete construction of the new Houston Ballet Foundation Center for Dance. The Note was assigned by Sanger to JPMorgan Chase Bank, N.A. and funds were advanced from the Note as necessary to cover new building-related costs. Interest on the outstanding and unpaid principal balance is due on the first business day monthly, beginning August 2, 2010 and will be initially computed at a per annum rate equal to 67% of the Applicable Base Rate (the rate of interest equal to the higher of either the Prime rate or the Adjusted One Month LIBOR Rate). The note is secured by the Deed of Trust for Land and Building at 601 Preston St. and Capital Campaign Pledges of the Foundation, maturing July 21, 2040. The Note requires payment of interest only for the first three years, until July 21, 2013, at which point, in addition to the interest payments, semi-annual principal payments will be made as scheduled for up to 27 years. The note payable balance at June 30, 2013 was $5,500,000.

The following are the aggregate maturities of the note for each of the five succeeding years ended June 30, and in total thereafter:

Year Ending June 30,	
2014	$ 200,000
2015	200,000
2016	300,000
2017	300,000
2018	400,000
Thereafter	4,100,000
	$ 5,500,000

NOTE I - EMPLOYEE BENEFITS

The Foundation contributes to a defined contribution retirement plan for the benefit of all dancers represented by Variable Annuity Life Insurance Company ("VALIC"). This plan is administered by VALIC. Contributions to the VALIC plan aggregated $154,382 for the year ended June 30, 2013.

The Foundation contributes to a defined contribution retirement plan for the benefit of all qualified, nonunion employees. Contributions to this plan, also administered by VALIC, aggregated $161,442 for the year ended June 30, 2013.

The Foundation contributes to a defined contribution retirement plan for the benefit of all musicians represented by American Federation of Musicians ("AFM"). Contributions to this plan, administered by AFM, aggregated $79,130 for the year ended June 30, 2013.

The Foundation has two tax-sheltered annuity programs for the benefit of its employees. Participating employees may contribute up to 20% of their annual income to one of the programs. All contributed amounts are managed by an independent trustee and are exempt from federal income taxes until such time as they are withdrawn.

The Foundation provides health insurance for qualified, nonunion employees through American Guild of Musical Artists ("AGMA"). Premiums paid by the Foundation for such insurance were $588,908 for the year ended June 30, 2013.

The Foundation provides health insurance to union dancers through AGMA. Premiums paid by the Foundation for such insurance were $461,219 for the year ended June 30, 2013.

The Foundation provides dental insurance for qualified nonunion employees. Premiums paid by the Foundation for such insurance were $26,728 for the year ended June 30, 2013.

The Foundation has an agreement to pay a lifetime retirement benefit of $55,000 per year, to a former employee. The actuarially determined liability for this obligation was recalculated assuming a life expectancy of 18.4 years and an investment return of 7.5%. The balance of the liability of $196,372 for this obligation and the fair market value of the related investment assets of $326,924 are included in the combined statement of financial position as of June 30, 2013. The employee retired and was vested in the plan as of July 1, 2003. Distributions in the aggregate amount of $37,908, net of tax, were paid during the year ended June 30, 2013.

The Foundation has an agreement to pay a current employee deferred compensation of $20,000 per annum plus 5% interest beginning July 1, 2010 over the duration of employment. The deferred compensation amounts will vest at 75% four years after the effective date and payments will begin on July 1, 2014. If the employee is still employed on his 55th birthday or acting in his service capacity with the Foundation on either his retirement date or on his involuntary termination date, all amounts will vest 100%. In addition, all amounts will become 100% vested on date of death or disability, as applicable. The balance of the liability of $86,206 for this obligation is included in the combined statement of financial position as of June 30, 2013 and the vested amounts will be paid out of general assets of the Foundation, although a separate investment account to fund the liability was established in July 2011.

NOTE I - EMPLOYEE BENEFITS (Continued)

The Foundation entered into an agreement to pay a 15-year retirement benefit of $30,000 per year, cost of living adjusted annually at a rate of 3.0%, beginning in March 2015 to a former employee. The actuarially determined liability for this obligation was calculated using an investment return of 4.5%. The balance of the liability of $238,390 for this obligation is included in the combined statements of financial position as of June 30, 2013 and will be paid out of general assets of the Foundation.

The Foundation entered into an agreement to contribute to a section 457(b) “top hat” plan on behalf of three current employees in an amount equal to the maximum amount allowed by IRS guidelines, currently $17,500 per calendar year. The net balance of the liability for these obligation as of June 30, 2013 is $26,250 and is included in the combined statement of financial position and will be paid out of general assets of the Foundation.

NOTE J - COMMITMENTS AND CONTINGENCIES

Grants, bequests and endowments require the fulfillment of certain conditions as set forth in the instructions of the gift. The Foundation intends to fulfill the conditions of all bequests, grants and endowments, recognizing that failure to fulfill the conditions could result in the return of the funds to donors. The Foundation, by accepting the gifts and their terms, has agreed to the conditions of the donor. Management believes that the Foundation has complied with all donors’ conditions.

The Foundation entered into a 30-year lease agreement with the Wortham Theater Foundation in May 1987. Upon expiration of the lease term and agreement of both parties, the lease may be renewed for an additional 30 years. The Foundation has the right to terminate the lease at any time, after giving six months written notice. Box office space is also leased. In February 2013, the Foundation entered into a 2-year lease agreement for office space for an outside vendor providing telemarketing and telefunding services for the Foundation. Rent expense for the year ended June 30, 2013 for these leases was $284,834.

General Liability Claims: The Foundation is, from time to time, subject to claims and suits arising in the ordinary course of business, including claims for damages for personal injuries and employment related claims. In certain of these actions, plaintiffs request punitive or other damages against the Foundation which may be covered by insurance. The Foundation is currently not a party to any proceeding which, in management’s opinion, would have a material adverse effect on the Foundation’s business, financial condition or results of operations.

NOTE K - SUBSEQUENT EVENTS

The Foundation has evaluated subsequent events through September 16, 2013 for recognition or disclosure, which is the date these combined financial statements were available for issuance. There were no other subsequent events requiring recognition or disclosure in these combined financial statements other than those disclosed herein. The Foundation received a restricted donation of $1,100,000 in August 2013 to underwrite the costs in connection with a new production scheduled to premiere during the fiscal year ending June 30, 2015.