

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Financial Statements

Year ended June 30, 2011

(With Independent Auditors' Report Thereon)

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Financial Statements

Year ended June 30, 2011

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Board of Directors
Philharmonic Society of Orange County
Irvine, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statements of financial position of Philharmonic Society of Orange County (a nonprofit organization) as of June 30, 2011 and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the management of Philharmonic Society of Orange County. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the financial statements of the Philharmonic Society of Orange County for the year ended June 30, 2010 and in our report dated January 31, 2011 we expressed an unqualified opinion on the 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philharmonic Society of Orange County as of June 30, 2011 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.

The Philharmonic Society of Orange County has an unrestricted net asset deficit that is described further in footnote 10 of the financial statements.

Mayer Hoffman McCann P.C.

Irvine, California
October 28, 2011

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY

Statement of Financial Position

June 30, 2011

(With comparative data for the prior year)

	Totals	
	2011	2010
<u>Assets</u>		
Cash and cash equivalents (note 2)	\$ 1,201,956	1,102,403
Accounts receivable	17,923	526
Contributions receivable (note 3)	277,490	709,721
Beneficial interest in trust (note 4)	104,923	106,951
Prepaid expenses	52,412	79,232
Property and equipment, net (note 5)	51,620	34,396
Other assets	380,249	84,999
Total assets	<u>\$ 2,086,573</u>	<u>2,118,228</u>
<u>Liabilities and Net Assets</u>		
Liabilities:		
Accounts payable and accrued expenses	\$ 138,291	201,423
Deferred revenue	596,128	615,200
Line of credit (note 6)	800,000	900,000
Note payable (note 7)	41,667	41,667
Total liabilities	<u>1,576,086</u>	<u>1,758,290</u>
Net Assets (notes 10 and 11):		
Unrestricted	(676,627)	(1,024,954)
Temporarily restricted	618,894	816,672
Permanently restricted	568,220	568,220
	<u>510,487</u>	<u>359,938</u>
Total liabilities and net assets	<u>\$ 2,086,573</u>	<u>2,118,228</u>

See accompanying notes to financial statements.

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY

Statement of Activities

Year ended June 30, 2011

(With comparative data for the prior year)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2011	2010
Revenues:					
Concert ticket sales	\$ 1,297,202	-	-	1,297,202	1,105,473
Contributions	1,438,539	408,681	-	1,847,220	1,761,322
Special Events:					
Spring gala revenue	250,870	-	-	250,870	121,432
Direct expenses	(58,234)	-	-	(58,234)	(9,830)
Net support from spring gala	192,636	-	-	192,636	111,602
Other special events	70,220	-	-	70,220	12,737
Direct expenses	(63,591)	-	-	(63,591)	(28,332)
Net support from other special events	6,629	-	-	6,629	(15,595)
Education and support groups	714,831	-	-	714,831	457,360
Investment income	1,381	-	-	1,381	3,777
Net assets released from donor restrictions (note 10)	606,459	(606,459)	-	-	-
Total revenues	4,257,677	(197,778)	-	4,059,899	3,423,939
Expenses:					
Concert production	1,940,635	-	-	1,940,635	1,705,343
Education	678,374	-	-	678,374	359,516
Fundraising and marketing	658,335	-	-	658,335	599,001
General and administrative	632,006	-	-	632,006	628,272
Total expenses	3,909,350	-	-	3,909,350	3,292,132
Increase (decrease) in net assets	348,327	(197,778)	-	150,549	131,807
Net assets (deficit) at beginning of year	(1,024,954)	816,672	568,220	359,938	228,131
Net assets at end of year	\$ (676,627)	618,894	568,220	510,487	359,938

See accompanying notes to financial statements.

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY
 Statements of Cash Flows
 Year ended June 30, 2011

(With comparative data for the prior year)

	2011	2010
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 150,549	131,807
Adjustments to increase (decrease) net assets to net cash provided by (used for) operating activities:		
Depreciation and amortization	7,938	9,751
(Increases) decreases due to changes in assets:		
Accounts receivable	(17,397)	1,236
Contributions receivable	432,231	(138,905)
Beneficial interest in trust	2,028	-
Prepaid expenses	26,820	33,810
Other assets	(295,250)	(32,720)
Increases (decreases) due to changes in liabilities:		
Accounts payable and accrued expenses	(63,132)	54,371
Deferred revenue	(19,072)	(69,624)
Total adjustments	74,166	(142,081)
Net cash provided by (used for) operating activities	224,715	(10,274)
Cash flows from investing activities:		
Purchase of equipment	(25,162)	(26,121)
Net cash provided by (used for) investing activities	(25,162)	(26,121)
Cash flows from financing activities:		
Proceeds of borrowings	800,000	920,251
Repayment of borrowings	(900,000)	(995,000)
Net cash provided by (used for) financing activities	(100,000)	(74,749)
Net increase (decrease) in cash and cash equivalents	99,553	(111,144)
Cash and cash equivalents at beginning of year	1,102,403	1,213,547
Cash and cash equivalents at end of year	\$ 1,201,956	1,102,403
<u>Supplemental disclosure cash flow information:</u>		
Cash paid during the year for interest	\$ 78,319	75,217

There were no significant non-cash investing and financing activities for the years ended June 30, 2011 and 2010.

See accompanying notes to financial statements.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2011

(1) Summary of Significant Accounting Policies

(a) Organization and Background

The accompanying financial statements include the accounts of the Philharmonic Society of Orange County (the "Society") and activities of the Philharmonic Committees, and the Scholarship and Endowment Funds.

The principal activities of the Philharmonic committees include coordination and monitoring of fundraising activities of 19 committees, and providing musical activities and education for the youth of Orange County.

(b) Basis of Accounting

The financial statements of the Philharmonic Society of Orange County have been prepared on the accrual basis of accounting. Under this method of accounting, revenues are recognized when earned and expenses are recognized when incurred.

(c) Financial Statement Presentation – Net Assets

The Society's financial statements are presented in accordance with Accounting Standards Codification (ASC) 958-205, *Financial Statements of Not-for-Profit Organizations* for net assets. Accordingly, the net assets of the Society are reported in each of the following three classes: (a) unrestricted net assets, (b) temporarily restricted assets, and (c) permanently restricted assets.

(a) *Unrestricted net assets* are those that are not subject to donor-imposed stipulations. The Society currently shows a negative unrestricted fund balance

(b) *Temporarily restricted net assets* are those stipulated by donors for specific operating purposes that require passage of time or the occurrence of a specific event.

(c) *Permanently restricted net assets* are those stipulated by donors that the corpus be invested in perpetuity while permitting the Society to use or expend part or all of the income derived from the donated assets.

(d) Contributions Received

The Society also follows ASC 958-605, *Accounting for Contributions Received and Contributions Made*. In accordance with ASC 958-605, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(e) Contributions Received, (Continued)

Unconditional promises to give are recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is received. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a 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.

(f) Accounting for Endowment Funds

In August 2008 the FASB issued FSP No. 117-1, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), and Enhanced disclosures for All Endowment Funds. FSP No. 117-1 improves disclosures about an organization's endowment funds (both donor restricted endowment funds and board restricted endowment funds). The State of California enacted UPMIFA effective January 1, 2009.

The Society has interpreted the law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the Society classifies permanently restricted endowment net assets at the original value of the gift donated to the permanent endowment. Remaining assets that have been restricted due to Society actions and not as a result of donor restrictions are classified as unrestricted net assets to be used upon Board approval.

(g) Investments

The Society follows ASC 958-320, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under ASC 958-320, the Society is required to report investments in certain equity securities and all debt services at fair market value. Net appreciation (depreciation) in the fair value of investments, which consists of the realized and unrealized gains or losses on those investments, is shown in the statement of activities.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(h) Fair Value Measurements

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices 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.

(i) Property and Equipment

Property and equipment are stated at historical cost or fair market value at the date of donation, if donated. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Depreciation is computed using the straight-line method over estimated useful lives of the assets that are five years for equipment and the life of the lease for leaseholds. When property is sold or abandoned, the related cost and accumulated depreciation or amortization is removed from the accounts and any gain or loss is reflected in operations.

(j) Impairment of Long-Lived Assets

The Society adopted the provisions of ASC 360-10, *Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of*. The standard requires that management review long-lived and certain identifiable assets for impairment whenever events or changes in circumstances indicate the carrying value of such assets may not be recoverable. The standard specifies the measurement procedures to determine the amount of adjustment, if any, required to reduce such assets to an appropriate value for financial statement purposes.

(k) Sick Time

Unused sick time is not paid to employees upon termination. As a result, no liability for sick time has been included in the accompanying financial statements.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(l) Revenue and Expense Recognition

Deferred revenue consists of advance ticket sales for future concerts. Costs and expenses directly related to future concerts are recorded as prepaid expenses. Ticket sales are recorded as revenue when a concert is performed and the related prepaid costs are charged to expense.

Income from the Philharmonic Committees, included as support groups and special events, is recognized in the year earned and is reported net of the related fundraising costs and expenses which approximated \$888,364 and \$553,367 for the years ended June 30, 2011 and 2010, respectively.

(m) Donated Services

A substantial number of volunteers and the directors and officers have donated their time and talent to the Society. No amounts are shown in the accompanying financial statements to reflect the value of these donated services. Services donated by professionals (as defined) are accounted for by the Society based upon the fair market value of the services rendered.

(n) Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Society considers all unrestricted highly liquid investments with an initial maturity of three months or less to be cash equivalents.

(o) Use of Estimates

The preparation of these financial statements requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amount of assets, liabilities, revenues, and expenses, as well as any contingent assets and liabilities. Actual results could differ from those estimates. Management also determines the accounting principles to be used in the preparation of financial statements.

(p) Income Tax Status

The Society has received determination letters from the Internal Revenue Service and the California Franchise Tax Board indicating that it qualifies for exemption from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code and California franchise taxes under Section 23701(d) of the California Revenue and Taxation Code.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(q) Expense Allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the "Statement of Activities". Accordingly, certain costs have been allocated among the program and supporting services benefited.

(r) Life Insurance Policy

The Society has a life insurance policy on the President/Artistic Director. The cash surrender of the life insurance policy less any outstanding loans against the policy have been reflected in the accompanying financial statement as Other Assets. The net cash surrender balance of the life insurance policy at June 30, 2011 is \$348,613 which is comprised of \$354,829 of accumulated value and a surrender charge of \$6,216.

(s) Comparative Data

The amounts shown for the year ended June 30, 2010 in the accompanying financial statements are included to provide a basis for comparison with 2011 and present summarized totals only. Accordingly, the 2010 totals are not intended to present all information necessary for a fair presentation in conformity with accounting principles generally accepted in the United States of America. Such information should be read in conjunction with the Society's financial statements for the year ended June 30, 2010, from which the information was derived.

(t) Subsequent Events

Subsequent events have been evaluated by management through October 28, 2011 which is the date the financial statements were available to be issued.

(2) Cash Equivalents and Investments

Cash and investments held by the Society are reported in the accompanying financial statements as follows at June 30, 2011:

Deposits	\$ 444,713
Money market accounts	168,746
Certificates of deposit	<u>588,497</u>

Total \$ 1,201,956

The investments above are categorized as Level 1 for fair value reporting.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(2) Cash Equivalents and Investments, (Continued)

The Society receives unconditional promises to give from patrons and benefactors, which include members, officers and directors of the Society who are located principally in Orange County. The Society does not require collateral as security for such promises to give. The Society is exposed to credit loss in the event of nonperformance by its patrons and benefactors.

(3) Contributions Receivable

Contributions receivable represent unconditional promises to give which will be collected in future periods. All contributions are expected to be collected in less than one year. Contributions have been discounted to their present value using the risk free rate of return applicable to each year. Contributions receivable as of June 30, 2011 are as follows:

Contributions	\$ 295,800
Less:	
Reserve for doubtful accounts	(17,748)
Present value discount on contributions	<u>(562)</u>
Total	<u>\$ 277,490</u>

(4) Beneficial Interest in Trust

Beneficial interest in trust represent two agreements naming the Society as beneficiaries. Since the Society does not know when the amounts will be collected the present value is calculated based on average life expectancy of the donor. Beneficial interest in trust as of June 30, 2011 are as follows:

Beneficial interest in trust	\$ 234,045
Less:	
Present value discount on beneficial interest in trust	<u>(129,122)</u>
Total	<u>\$ 104,923</u>

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(5) Property and Equipment

Property and equipment consist of the following at June 30, 2011:

Office equipment	\$ 134,737
Leasehold improvements	6,248
Music mobile	<u>68,104</u>
Subtotal	209,089
Less: Accumulated depreciation	<u>(157,469)</u>
Total	<u>\$ 51,620</u>

(6) Line of Credit

The Society entered into a \$800,000 secured line of credit with American Business Bank that matures on November 3, 2011. Interest is payable monthly at a rate of 5% through November 5, 2010. The interest rate may be changed by the bank to the American Business Bank Referenced Rate plus 1%. However, the rate will never be less than 5%. The line of credit is secured by inventory, accounts receivable, intangibles, equipment, and specific property. The outstanding line of credit payable at June 30, 2011 was \$800,000.

(7) Notes Payable

The Society entered into a \$100,000 note payable with American Business Bank in November 2010. Principal of \$8,333 and accrued interest are payable monthly on the last day of each month with the final payment due on November 3, 2011. Interest accrues at a 5% through November 5, 2010, after which time it may change to the bank to the American Business Bank Referenced Rate plus 1%. However, the rate will never be less than 5%. The note is secured by inventory, intangibles, equipment, and specific property. The outstanding balance of the note payable at June 30, 2011 was \$41,667.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(8) Committee Activities

Committee Activities are recorded in *Education and Support Groups* revenue and *Education* expenses on the accompanying Statement of Activities. For the year ended June 30, 2011, Committee Activities included the following:

	<u>House of Design</u>	<u>Cruise of Lights</u>	<u>Other Activities</u>	<u>Total</u>
Revenues	\$470,436	87,020	120,416	677,872
Expenses	<u>235,369</u>	<u>48,173</u>	<u>39,099</u>	<u>322,641</u>
	<u>\$235,067</u>	<u>38,847</u>	<u>81,317</u>	<u>355,231</u>

(9) Commitments

The Society contracts for the services of various orchestras and performers for the ensuring concert sessions. Contractual commitments were \$1,219,500 at June 30, 2011.

The Society's 2011/2012 concert series will be performed at the Renee and Henry Segerstrom Concert Hall and the Irvine Barclay Theater. The Society has entered into limited use license agreements with the Concert Hall and the Barclay Theater. Pursuant to the agreements, the Society is committed to pay various fees for use of the facilities and the greater of \$2,500 or 10% of gross ticket revenues to the Concert Hall and the greater of \$1,450 or 15% of gross ticket revenues (not to exceed \$3,500) to the Barclay Theater.

The Society is obligated under a lease on its administrative facilities to December 31, 2015. The lease agreement requires monthly lease payments of \$5,850 per month, the agreement states that rent is free for the month of December.

The following is a schedule of future minimum lease payments as of June 30, 2011:

<u>Year ended June 30:</u>	
2012	\$ 29,250
2013	64,350
2014	64,350
2015	64,350
2016	<u>29,250</u>
Total	<u>\$ 251,550</u>

Rental expense for the year ended June 30, 2011 was \$66,175.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

(Continued)

(10) Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets at June 30, 2011 are summarized as follows:

Temporarily restricted:	
2011/2012 concert season	\$ 236,481
Beneficial interest in trust	104,923
Time restriction for contributions receivable	<u>277,490</u>
Total temporarily restricted net assets	<u>\$ 618,894</u>
Permanently restricted:	
Endowment fund	\$ 390,216
Educational scholarships	<u>178,004</u>
Total permanently restricted net assets	<u>\$ 568,220</u>

Net assets released from donor restriction by satisfying the purpose of the restriction or the passage of time were comprised of the following for the year ended June 30, 2011:

Purpose restrictions accomplished:	
Due to the passage of time	<u>\$ 606,459</u>
Total	<u>\$ 606,459</u>

(11) Unrestricted Net Asset Deficit

The Society has an unrestricted net asset deficit at June 30, 2011 of \$676,627. The deficit unrestricted net assets balance is a result of approximately \$800,000 in losses suffered in the year ended June 30 2006 related to the opening of the new Segerstrom Concert Hall. Additionally, the Society relies on its lines of credit that expire throughout 2011 and 2012. If the line of credit is not renewed by the bank, management would have difficulty paying its bills on time.

Management has implemented significant administrative and overhead expense cuts and intends to begin a development campaign for the main purpose of solidifying its cash position.