

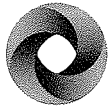
Consolidated Financial Statements and Report of
Independent Certified Public Accountants

The Philadelphia Orchestra Association

August 31, 2008 and 2007

Contents

	Page
Report of Independent Certified Public Accountants	3
Consolidated financial statements	
Consolidated statements of financial position	5
Consolidated statements of activities	6
Consolidated statements of cash flows	7
Notes to consolidated financial statements	8



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Report of Independent Certified Public Accountants

To the Board of Directors of
The Philadelphia Orchestra Association:

We have audited the accompanying consolidated statement of financial position of The Philadelphia Orchestra Association, and its wholly owned subsidiary (collectively, the "Association") as of August 31, 2008, and the related consolidated statements of activities and changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Association'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 Association's fiscal 2007 consolidated information. As discussed in Note B19, the Association has restated its 2007 financial statements during the current year to reflect the proper accounting treatment for a funding agreement with the Commonwealth of Pennsylvania, contributed real property classification, net asset classification of realized and unrealized gains and losses, contribution recognition and building improvements in conformity with accounting principles generally accepted in the United States of America. The financial statements of the Association as of and for the year ended August 31, 2007, were audited by other auditors. Those auditors expressed an unqualified opinion on those consolidated financial statements in their report dated April 10, 2008.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. 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 Association'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, the 2008 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Philadelphia Orchestra Association and its wholly owned subsidiary as of August 31, 2008, and the consolidated changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also have audited the adjustments as described in Note B19 to the consolidated financial statements that were applied to restate the August 31, 2007 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review or apply any procedures to the 2007 consolidated financial statements of the Association other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on those 2007 consolidated financial statements taken as a whole.

Grant Thornton LLP

Philadelphia, Pennsylvania

March 12, 2009

The Philadelphia Orchestra Association

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

August 31,

(Dollars in thousands)

ASSETS	<u>2008</u>	<u>2007</u> (As restated)
Cash and cash equivalents	\$ 8,353	\$ 5,868
Trade accounts receivable, net of allowance of \$167 and \$167	2,474	1,741
Prepaid expenses	2,488	2,790
Pledges receivable, net	13,408	17,850
Notes receivable	262	335
Investments	166,658	185,712
Investment in joint venture	575	575
Property, plant and equipment, net	44,112	42,824
Beneficial interest in trusts	<u>4,436</u>	<u>4,992</u>
 Total assets	 <u>\$ 242,766</u>	 <u>\$ 262,687</u>
 LIABILITIES AND NET ASSETS		
Line of credit	\$ 8,000	\$ 7,300
Accounts payable	1,390	1,580
Accrued expenses	2,020	1,047
Deferred revenue	8,958	9,313
Annuities payable	1,102	992
Bonds payable	3,200	3,500
Other liabilities	63	113
Accrued benefit obligation	<u>9,848</u>	<u>8,294</u>
 Total liabilities	 34,581	 32,139
 NET ASSETS		
Unrestricted	45,833	50,386
Temporarily restricted	21,950	42,002
Permanently restricted	<u>140,402</u>	<u>138,160</u>
 Total net assets	 <u>208,185</u>	 <u>230,548</u>
 Total liabilities and net assets	 <u>\$ 242,766</u>	 <u>\$ 262,687</u>

The accompanying notes are an integral part of these statements.

The Philadelphia Orchestra Association

CONSOLIDATED STATEMENTS OF ACTIVITIES

Year ended August 31, 2008 (with summarized information for the year ended August 31, 2007)

	Unrestricted	Temporarily restricted	Permanently restricted	2008 total	2007 total
	(Dollars in thousands)				(As restated)
PERFORMANCE REVENUES					
Philadelphia concerts	\$ 11,395	\$ -	\$ -	\$ 11,395	\$ 11,221
Summer concerts	1,957	-	-	1,957	1,865
Other concerts	987	-	-	987	885
Tours	1,609	-	-	1,609	1,682
Recording, radio and television	230	-	-	230	208
	<u>16,178</u>	<u>-</u>	<u>-</u>	<u>16,178</u>	<u>15,861</u>
PERFORMANCE EXPENSES					
Orchestra and concert production	33,278	-	-	33,278	31,406
Recording, radio and television	824	-	-	824	712
	<u>34,102</u>	<u>-</u>	<u>-</u>	<u>34,102</u>	<u>32,118</u>
PERFORMANCE DEFICIT	(17,924)	-	-	(17,924)	(16,257)
OTHER OPERATING REVENUES					
Annual public support	12,124	3,107	-	15,231	12,900
Volunteer project revenue	633	495	-	1,128	1,312
Investment return, designated for current operations	9,684	-	-	9,684	9,382
Other revenues	1,323	-	-	1,323	1,008
Gifts in kind	77	-	-	77	267
Investment in joint venture	187	-	-	187	341
(Expense) revenue from Encore Series, Inc.	(246)	-	-	(246)	420
Special events revenue	120	-	-	120	557
Net assets released from restrictions	2,281	(2,281)	-	-	-
	<u>26,183</u>	<u>1,321</u>	<u>-</u>	<u>27,504</u>	<u>26,187</u>
TOTAL OTHER OPERATING REVENUES					
OTHER OPERATING EXPENSES					
Fundraising expenses					
Annual fundraising	1,480	-	-	1,480	1,147
Volunteer project	468	-	-	468	437
	<u>1,948</u>	<u>-</u>	<u>-</u>	<u>1,948</u>	<u>1,584</u>
Management and general					
Administrative expense	9,589	-	-	9,589	8,773
Bad debt	9	-	212	221	65
	<u>9,598</u>	<u>-</u>	<u>212</u>	<u>9,810</u>	<u>8,838</u>
TOTAL OTHER OPERATING EXPENSES	<u>11,546</u>	<u>-</u>	<u>212</u>	<u>11,758</u>	<u>10,422</u>
CHANGES IN NET ASSETS FROM OPERATING ACTIVITIES BEFORE DEPRECIATION	(3,287)	1,321	(212)	(2,178)	(492)
Depreciation	432	-	-	432	322
CHANGES IN NET ASSETS FROM OPERATING ACTIVITIES	(3,719)	1,321	(212)	(2,610)	(814)
NON OPERATING REVENUE (EXPENSE)					
Endowment contributions	-	-	6,814	6,814	5,596
Endowment fundraising expenses	(750)	-	-	(750)	(753)
Investment (loss) return, net of spending policy	(4,005)	(19,520)	(767)	(24,292)	11,557
Investment return, designated for Academy of Music	-	901	-	901	850
Academy of Music contributions and other income	5,771	-	-	5,771	10,214
Academy of Music expense	(5,979)	-	-	(5,979)	(3,948)
Redesignation of net assets	5,614	(2,021)	(3,593)	-	-
Net assets released from restrictions	733	(733)	-	-	-
(Loss) gain on pension benefit obligation	(2,218)	-	-	(2,218)	2,620
	<u>(834)</u>	<u>(21,373)</u>	<u>2,454</u>	<u>(19,753)</u>	<u>26,136</u>
TOTAL NON OPERATING REVENUE (EXPENSE)					
CHANGES IN NET ASSETS BEFORE THE EFFECT OF ADOPTION OF FAS 158	(4,553)	(20,052)	2,242	(22,363)	25,322
EFFECT OF ADOPTION OF FAS 158	-	-	-	-	(834)
CHANGES IN NET ASSETS	(4,553)	(20,052)	2,242	(22,363)	24,488
NET ASSETS, BEGINNING - AS RESTATED Note B19	<u>50,386</u>	<u>42,002</u>	<u>138,160</u>	<u>230,548</u>	<u>206,060</u>
NET ASSETS, ENDING	<u>\$ 45,833</u>	<u>\$ 21,950</u>	<u>\$ 140,402</u>	<u>\$ 208,185</u>	<u>\$ 230,548</u>

The accompanying notes are an integral part of these statements.

The Philadelphia Orchestra Association

STATEMENTS OF CASH FLOWS

Year ended August 31,

(Dollars in thousands)

	<u>2008</u>	<u>2007</u>
		(As restated)
Cash flows from operating activities		
Change in net assets	\$ (22,363)	\$ 24,488
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities		
Depreciation of property, plant and equipment	2,418	2,276
Provision for bad debt expense	(838)	-
Permanently restricted contributions received	(7,260)	(20,397)
Net realized and unrealized loss (gain) return on investments	23,909	(9,833)
Unrealized depreciation (appreciation) in beneficial interest in trust	302	(554)
Minimum pension liability adjustment	2,218	(2,620)
Effect of adoption of FASB Statement No. 158	-	834
Changes in assets and liabilities		
(Increase) decrease in trade accounts receivable	(733)	489
Decrease in pledges receivable	5,280	12,852
Decrease (increase) in prepaid expenses	302	(366)
Decrease in other assets	-	85
Distribution from beneficial interest in trust	254	245
Increase (decrease) in accounts payable and accrued expenses	783	(73)
Decrease in deferred revenues	(355)	(226)
Increase in annuities payable	110	136
Decrease in accrued benefit obligations	(664)	(126)
Decrease in other liabilities	(50)	(50)
Net cash provided by operating activities	<u>3,313</u>	<u>7,160</u>
Cash flows from investing activities		
Purchases of investments	(101,020)	(90,065)
Proceeds from sales of investments	96,164	67,447
Purchase of property, plant and equipment	(3,705)	(1,494)
Loan disbursements to employees	(44)	(92)
Repayments of employee loans	117	71
Net cash used in investing activities	<u>(8,488)</u>	<u>(24,133)</u>
Cash flows from financing activities		
Payments of bonds payable	(300)	(300)
Permanently restricted contributions received	7,260	20,397
Proceeds from line of credit	8,000	7,300
Repayment on line of credit	(7,300)	(8,500)
Net cash provided by financing activities	<u>7,660</u>	<u>18,897</u>
Net increase in cash and cash equivalents	2,485	1,924
Cash and cash equivalents		
Beginning of year	<u>5,868</u>	<u>3,944</u>
End of year	<u>\$ 8,353</u>	<u>\$ 5,868</u>
Interest paid	<u>\$ 359</u>	<u>\$ 511</u>

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE A - NATURE OF OPERATIONS

1. Organization

These consolidated financial statements include the accounts of The Philadelphia Orchestra Association (the "Orchestra") and its wholly-owned subsidiary the Academy of Music of Philadelphia, Inc. (the "Academy") (collectively the "Association"). All significant intercompany balances and transactions have been eliminated. The Academy was organized to operate, manage and maintain the Academy of Music. The operations of the Academy are managed by the Kimmel Center, Inc. ("KCI") an unaffiliated organization. In addition, the Association has invested in a nonprofit joint venture which provides ticket sales and servicing operations for events held in the Academy, Kimmel Center and other venues ("Ticket Philadelphia"). This venture is accounted for as an equity investment. As more fully discussed in Note M, the Association also has an administrative relationship with Encore Series, Inc.

2. Definition of Operating Activities

The operations of the Orchestra, including all concert, recording, and touring activities are presented in the operating activities section of the statement of activities. Also included with operating activities are all Orchestra annual fund raising activities, as well as earnings from endowment as determined using the spending rate method of investment income allocation as described below. Depreciation for the Orchestra's operating assets is included in other operating activities in the consolidated statement of activities. Depreciation for the Academy's assets is included in Academy of Music expense in Non Operating Expense. The Orchestra owns the Academy of Music, which is managed by KCI. Operating results of the Academy of Music are not included in these statements as they are part of KCI's operations. KCI leases the property of the Academy for a dollar a year through 2031. The lease contains various options to extend at current market rates through 2090.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Presentation

The financial statements of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America. The Association presents its financial statements in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 117, *Financial Statements of Not for Profit Organizations*. This statement requires that net assets and revenues, gains, expenses and losses be classified as unrestricted, temporarily restricted or permanently restricted based on the existence or absence of donor-imposed restrictions as follows:

- Unrestricted - Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors. Approximately \$35,269,000 and \$35,579,000 of the Association's unrestricted net assets at August 31, 2008 and 2007, respectively, have been designated by the Board of Directors to function as endowment. The principal of these funds cannot be used for any other purpose without further action by the Board of Directors.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- Temporarily Restricted - Net assets whose use by the Association is subject to donor-imposed restrictions that can be fulfilled by actions of the Association pursuant to those restrictions or that expire by the passage of time. Temporarily restricted net assets consist primarily of contributions receivable and accumulated endowment gains which can be expended, but for which restrictions have not yet been met.
- Permanently Restricted - Net assets subject to donor-imposed restrictions that they be maintained permanently by the Association or are permanently maintained in the control of third-party trustees or administrators. Permanently restricted assets are primarily comprised of original endowment gifts given to the Association by donors. Generally, the donors of these assets permit the Association to use all or part of the income on these assets.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are generally reported as decreases in unrestricted net assets. Expirations of donor-imposed restrictions that simultaneously increase one class of net assets and decrease another are reported as releases between the applicable classes of net assets.

2. Comparative Financial Information

The financial statements include certain prior year information which has been summarized. This information was derived from the Association's fiscal 2007 consolidated information. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements of the Association as of and for the year ended August 31, 2007 have been restated as discussed in Note B19. Accordingly, such information should be read in conjunction with the financial statements as of and for the year ended August 31, 2007 and the information contained in Note B19 from which the summarized information was derived.

3. Cash and Cash Equivalents

Cash and cash equivalents include short term investments with original maturities of three months or less. The Association maintains cash accounts, which, at times, may exceed federally insured limits. The Association has not experienced any losses from maintaining cash accounts in excess of federally insured limits. Management believes that it is not exposed to any significant credit risk on its cash accounts.

4. Trade Accounts Receivable

Trade accounts receivable consists of performance related receivables, royalties, Academy Ball program receivables and other amounts.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. Property and Equipment

Property and equipment, net is recorded at cost as of the date of acquisition or fair value as of the date of receipt in the case of gifts. Depreciation is recorded as an expense using the straight-line method of depreciation over the estimated useful lives of the respective assets. The useful lives are as follows:

Office condominium, building and building improvements	30 years
Equipment and other	5-10 years
Office equipment	3-10 years

The cost and accumulated depreciation of property sold or retired is removed from the related asset and accumulated depreciation amounts and any resulting gain or loss is recorded in the period of disposal.

Renewals and improvements which extend the useful lives of assets are capitalized at cost. Maintenance and repairs are included as expenses in the consolidated statement of activities.

Fine instruments have been recognized at their estimated fair value based upon appraisals or similar valuations at the date of acquisition or donation. Fine instruments are not depreciated. The aggregate carrying value of such assets at both June 30, 2008 and 2007 is \$295,000.

6. Investments

The Association records investments at fair value. Debt securities, equity securities and mutual funds are valued at quoted market prices. Alternative investments are recorded at the estimated fair value established by the fund managers and reviewed by the investment consultant. Because such investments are not readily marketable, their estimated value is subject to uncertainty, and, therefore, may differ from the value that would have been used had a ready market for such investments existed. The Association reviews and evaluates the values provided by the outside parties and agrees with the valuation methods and assumptions used in determining the fair value of alternative investments.

Gains and losses on investments are determined using an average cost method for securities and the specific identification method for other investments. Gains and losses are based on the trade date for investments.

The Association has adopted an endowment spending policy which designates a portion of the cumulative investment return for support of current operations. The remainder is retained to support operations of future years and to offset potential market declines. This policy provides for spending a percentage of the average market value of the funds (as of August 31st) for the prior twelve quarters immediately preceding the fiscal year. Commonwealth of Pennsylvania law permits organizations to allocate to income each year a portion of permanently restricted investment net gains under a total return spending rate policy. The Association authorized a spending rate of 5.95% and 5.75% in fiscal 2008 and 2007, respectively for both its unrestricted and permanently restricted endowment investments unless the donor agreement differs.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The Association has an endowment agreement with the Annenberg Foundation for capital improvements to the Academy of Music and limits the spending rate to 5.5% annually (see Note K).

The Association has another endowment agreement with the Annenberg Foundation for orchestra activities and limits the spending rate not to exceed 6.25% prior to June 30, 2008 and 5.5% after June 30, 2008.

The Association's permanent endowment for the Academy of Music spending amount is capped at 12.4% of the value of the rent agreement with KCI which amounted to \$294,000 and \$284,000 at August 31, 2008 and 2007, respectively.

To the extent that actual income from permanently restricted investments is less than the predetermined amount, accumulated gains are made available for operations to fund the difference. For financial statement purposes, any excess accumulated gains or accumulated losses are recorded as temporarily restricted net assets. Investment return in excess of or less than the spending distribution is reported as a component of non operating revenue.

For unrestricted endowment, investment return in excess of or less than the spending distribution is reported as a component of non operating revenue.

7. Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based upon management's judgment including such factors as prior collection history and type of receivable. The Association writes-off receivables when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

8. Pledges Receivable

Contributions which are received subject to restrictions imposed by donors are reported as either permanently restricted or temporarily restricted net assets in the accompanying consolidated financial statements. Contributions for which the restrictions expire with the passage of time or occurrence of specific events are classified as temporarily restricted. When the restriction expires or upon occurrence of the specified event, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted funds expended in the fiscal year in which received are recorded immediately as unrestricted.

9. Notes Receivable

The Association makes loans to members of the Orchestra for the purpose of acquiring instruments to be used when performing with the Orchestra. The Association makes individual loans for amounts up to \$15,000 which are noninterest-bearing for a maximum term of 5 years. The total outstanding amount of these loans cannot exceed \$125,000. The Association also makes individual loans which bear interest at the ten-year Treasury note rate plus 1% for amounts up to \$125,000 with a maximum term of 10 years. The ten-year Treasury note rate was 3.83% and 4.54% at August 31, 2008 and 2007, respectively. The total outstanding amount of these loans cannot exceed \$500,000. Notes receivable were \$262,000 and \$335,000 as of August 31, 2008 and 2007, respectively.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

10. Charitable Gift Annuities

Liabilities related to charitable gift annuities received by the Association are recorded at the present value of the future interest payments based on the donor's life expectancy. Amounts donated in excess of the liability are recorded as temporarily restricted donations in the statement of activities. The present value of the annuities, discounted at the respective rate under IRC Section 7520(a), is calculated at the time of the donation.

11. Redesignation of Net Assets

Redesignation of net assets represents a previously donor restricted contribution whereby the donor withdrew the previously imposed restriction during the year ended August 31, 2008.

12. Revenue Recognition

Revenues from concert, recording, touring and rental activities are recognized as earned using the accrual method of accounting. Revenue from sales of subscriptions and single tickets for the upcoming concert season is deferred until the performance of the related concerts. Revenues related to advertising for the annual Academy Ball fund-raising event are deferred until earned. Deferred revenues were \$8,958,000 and \$9,313,000 as of August 31, 2008 and 2007, respectively.

13. Fair Value of Financial Instruments

Estimated fair values of financial instruments that differ from the carrying amount have been determined by the Association using available market information. The estimates are not necessarily indicative of the amounts the Association could realize in a current market exchange.

The carrying amount of cash and cash equivalents approximate fair value due to the short maturity of those financial instruments. Accounts receivable, pledges receivable and notes receivable approximate fair value based on current present value. Investments are carried at fair value based on quoted market prices. Certain investments in limited partnerships are recorded at approximate fair value as reported by the investment managers. Assets held by others approximate fair value on the quoted market price of investments held by Trustees.

The carrying amount of accounts payable, accrued liabilities including deferred revenues, line of credit and bonds payable, approximates the fair value of these financial instruments.

14. Tax Status

Under provisions of the Internal Revenue Code, Section 501(c)(3), and the applicable income tax regulations of Pennsylvania, the Association is exempt from taxes on income other than unrelated business income.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

15. 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 utilize assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant management estimates and assumptions relate to the determination of allowances for doubtful trade accounts, pledges and notes receivables, discounts on pledges receivable and annuities, alternative investment values, useful lives of fixed assets, assumptions related to the accrued benefit obligation, assumptions related to the annuities payable and the reported fair values of certain of the Association's assets and liabilities. Actual results could differ from those estimates.

16. Reclassifications

Certain 2007 amounts have been reclassified to conform to the 2008 financial statement presentation.

17. Recently Adopted Accounting Standards

On September 1, 2007, the Association adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48 requires that a tax position be recognized or derecognized based on a "more likely than not" threshold. This applies to positions taken or expected to be taken in a tax return. The implementation of FIN 48 had no impact on the Association's statement of financial position or statement of activities. The Association does not believe its financial statements include any uncertain tax positions.

The Association follows the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an Amendment of FASB Statements No. 87, 88, 106 and 132R*. The amendments retain most of the existing measurement and disclosure guidance. SFAS No. 158 requires companies to recognize a net asset or liability by which the defined-benefit-postretirement obligation is over or under-funded. SFAS No. 158 requires prospective application, and the recognition and disclosure requirements were effective for the fiscal year ending August 31, 2007. The effect of adopting SFAS No. 158 for the fiscal year ended August 31, 2007 resulted in a \$834,000 increase in liability for pension benefits.

18. Pending New Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement*. This new standard provides guidance for using fair value to measure assets and liabilities. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. The standard clarifies that for items that are not actively traded, such as certain kinds of derivatives, fair value should reflect the price in a transaction with a market participant, including an adjustment for risk, not just the organization's mark-to-market value. SFAS No. 157 also requires expanded disclosure of the effect on earnings for items measured using unobservable data.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. The Association intends to adopt SFAS No. 157 as it applies to its fiscal year ending August 31, 2009 and is evaluating the impact.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an Amendment of FASB Statements No. 87, 88, 106, and 132R*. SFAS No. 158 requires companies to (1) fully recognize, as an asset or liability, the overfunded or underfunded status of defined pension and other postretirement benefit plans; (2) recognize changes in the funded status through other changes in unrestricted net assets in the year in which the changes occur; (3) measure the funded status of defined pension and other postretirement benefit plans as of the date of the company's fiscal year-end; and (4) provide enhanced disclosures.

The Association adopted numbers (1), (2) and (4) as disclosed in Note B17 above. The Association is required to measure the funded status of all its defined benefit postretirement plans as of the balance sheet date beginning on August 31, 2009. The Association is currently evaluating the impact of this measurement date change.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement 115*. SFAS No. 159 permits entities to choose to measure certain financial instruments and other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Association is currently evaluating whether to adopt SFAS No. 159 as it applies to its fiscal year ending August 31, 2009.

In August 2008, the FASB issued Staff Position ("FSP FAS") No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*. FSP FAS 117-1 requires all not-for-profit organizations with donor-restricted or board-restricted endowment funds to make extensive new disclosures about such funds, regardless of whether the organization is subject to an enacted version of UMIFA. The standard is effective for financial statements issued for fiscal years ending after December 15, 2008. The Association plans to adopt this new guidance for the fiscal year ending August 31, 2009 and is evaluating the impact.

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

19. Restatement of Financial Statements

Net assets at August 31, 2006 and the effects on the 2007 consolidated financial statement have been restated for the following issues: a) the timing of the recording of a significant grant award, b) reclassification of contributed real property from investments to property, c) adjustments to the net assets classifications for realized and unrealized gains and losses on investments, d) recording a multi-year contribution and e) adjustments to property, plant and equipment.

- a) Funding agreement with the Commonwealth of Pennsylvania - During fiscal years 2007 and 2006, the Orchestra was informed by several representatives of the Commonwealth of Pennsylvania of an intention to recommend funding for the Association. The documentation confirming an unconditional promise to give in accordance with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* was received after year-end but before the completion of the audit. Therefore, the Association recorded the award for the full amount in 2007 and 2006. To correct this error, the Orchestra recorded the \$1,100,000 previously recorded in fiscal year 2007 into fiscal year 2008 and \$700,000 previously recorded in fiscal year 2006 into fiscal year 2007. As a result, the net assets at August 31, 2007 decreased by \$400,000.
- b) Contributed real property reclassification - During fiscal year 2002, the Orchestra received a testamentary gift of a condominium unit (the "Unit"). The donor's last will and testament specified that the Unit was to be used as a residence for the music director of the Orchestra or other purpose as determined. The will further stated that in the event a decision is made to sell the Unit, the proceeds shall be used to establish a perpetual charity fund. The Orchestra recorded the Unit as an investment at the appraised value at the time the estate assets were distributed. The Unit has been used as a residence for the music director and should be characterized as property and temporarily restricted net assets and should be depreciated accordingly. The Orchestra has reclassified the value of the Unit to temporarily restricted net assets in the amount of \$1,150,000 and recorded depreciation of \$211,000. In the event that the Unit is sold, the proceeds from the sale will be recorded as permanently restricted net assets.
- c) Net asset classification of realized and unrealized gains and losses - As a result of management's review conducted in fiscal year 2008 of the Association's endowment spending policy, management discovered errors in the classification of certain investment activity. Realized and unrealized gains and losses in excess of the spending policy for permanently restricted endowments was improperly recorded in permanently restricted net assets instead of temporary restricted net assets. In addition, realized and unrealized gains and losses on permanently restricted endowment funds with no designation by donor were incorrectly recorded as unrestricted net assets instead of temporarily restricted net assets. Please refer to the table below for amounts recorded.
- d) Contribution recognition - The Orchestra received notification of a multi-year promise to give in the year ending August 31, 2007 in the amount of \$675,000, with equal payments to be made over three years in the amount of \$225,000 per year. The Orchestra recorded one-third of the total gift in the year ended August 31, 2007. The full amount of the promise to give should have been recorded in the year ended 2007. As a result, the Orchestra has recorded an additional \$450,000 in revenue in 2007.

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- e) Building improvements - Certain buildings and improvements totaling \$4,500,000 were recorded on the books of the Academy of Music and not being depreciated. These improvements were disclosed in prior years as Building improvements at historical value. The Association does not have any records or physical inventory to support these assets. To correct this error, beginning net assets was reduced by \$4,500,000.

The effect of these adjustments on the individual net asset categories of the Philadelphia Orchestra is summarized as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets as of August 31, 2006 as previously reported	\$ 61,245,000	\$ 7,119,000	\$ 143,069,000	\$ 211,433,000
To reclassify funding from Commonwealth (Note 19a)	(700,000)	-	-	(700,000)
Depreciation of Unit (Note 19b)	-	(173,000)	-	(173,000)
Write-off of building improvements (Note 19e)	(4,500,000)	-	-	(4,500,000)
Net asset reclassifications (Note 19c)	<u>(13,657,000)</u>	<u>24,555,000</u>	<u>(10,898,000)</u>	<u>-</u>
Net assets as of August 31, 2006, as restated	<u>\$ 42,388,000</u>	<u>\$ 31,501,000</u>	<u>\$ 132,171,000</u>	<u>\$ 206,060,000</u>
Changes in net assets as previously reported	\$ 10,096,000	\$ (274,000)	\$ 14,654,000	\$ 24,476,000
To reclassify funding from Commonwealth (Note 19a)	(400,000)	-	-	(400,000)
Depreciation of Unit (Note 19b)	-	(38,000)	-	(38,000)
Contribution (Note 19d)	-	450,000	-	450,000
Net asset reclassifications (Note 19c)	<u>(1,698,000)</u>	<u>10,363,000</u>	<u>(8,665,000)</u>	<u>-</u>
Changes in net assets from restatements	(2,098,000)	10,775,000	(8,665,000)	12,000
Changes in net assets, as restated	<u>7,998,000</u>	<u>10,501,000</u>	<u>5,989,000</u>	<u>24,488,000</u>
Net assets as of August 31, 2007, as restated	<u>\$ 50,386,000</u>	<u>\$ 42,002,000</u>	<u>\$ 138,160,000</u>	<u>\$ 230,548,000</u>

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE C - INVESTMENTS

At August 31, 2008 and 2007, the fair value of investments was as follows:

	<u>2008</u>	<u>2007</u>
Money market funds	\$ 1,415,000	\$ 1,729,000
Corporate bonds	-	106,000
Corporate equities	27,848,000	28,652,000
Mutual funds		
Fixed income	34,776,000	37,815,000
Equities	53,311,000	57,659,000
Foreign Investments	28,532,000	37,970,000
Alternative investments		
Long/Short Domestic funds	7,093,000	7,162,000
Long/Short International funds	2,967,000	3,254,000
Absolute return/Mixed Strategy	<u>10,716,000</u>	<u>11,365,000</u>
Total investments	<u>\$ 166,658,000</u>	<u>\$ 185,712,000</u>

The above amounts include \$21,561,000 and \$23,624,000 of endowment funds for the benefit of the Academy of Music at August 31, 2008 and 2007, respectively. Also included above are operating investments of \$56,000 and \$55,000 for the years ended August 31, 2008 and 2007.

During 2008, 2007, 2006, 2005, and 2002, the Endowment Fund loaned the Operating Fund \$1,200,000, \$1,200,000, \$1,200,000, \$2,000,000, and \$4,500,000, respectively, of which \$1,300,000 has been repaid at August 31, 2008. The balance of the loan was \$8,800,000 and \$7,600,000 as of August 31, 2008 and 2007, respectively. In 2008, the board approved a transfer of \$1,650,000 from the board designated endowment fund to the operating fund.

Components of investment (loss) return for the year ended August 31, 2008 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Realized gains	\$ 892,000	\$ 3,658,000	\$ -	\$ 4,550,000
Unrealized losses	<u>(4,263,000)</u>	<u>(23,040,000)</u>	<u>(556,000)</u>	<u>(27,859,000)</u>
Realized and unrealized losses, net	(3,371,000)	(19,382,000)	(556,000)	(23,309,000)
Change in charitable gift annuity	-	-	(211,000)	(211,000)
Dividend and interest received	<u>1,403,000</u>	<u>8,410,000</u>	<u>-</u>	<u>9,813,000</u>
Total	<u>\$ (1,968,000)</u>	<u>\$ (10,972,000)</u>	<u>\$ (767,000)</u>	<u>\$ (13,707,000)</u>

Unrealized losses are net of investment expenses of \$537,000.

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE C - INVESTMENTS - Continued

Components of investment return for the year ended August 31, 2007, as restated, are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Realized gains	\$ 349,000	\$ 2,197,000	\$ -	\$ 2,546,000
Unrealized losses	<u>1,787,000</u>	<u>8,609,000</u>	<u>309,000</u>	<u>10,705,000</u>
Realized and unrealized losses, net	2,136,000	10,806,000	309,000	13,251,000
Change in charitable gift annuity	-	-	(94,000)	(94,000)
Dividend and interest received	<u>1,269,000</u>	<u>7,363,000</u>	<u>-</u>	<u>8,632,000</u>
Total	<u>\$ 3,405,000</u>	<u>\$ 18,169,000</u>	<u>\$ 215,000</u>	<u>\$ 21,789,000</u>

Unrealized losses are net of investment expenses of \$535,000.

NOTE D - ENDOWMENT ASSETS HELD BY OTHERS

The Association is the beneficiary of a number of irrevocable perpetual trusts held by third parties. The Association records the fair value of its interest in these trusts (\$4,436,000 at August 31, 2008 and \$4,992,000 at August 31, 2007) in the accompanying consolidated statement of financial position. Distributions received from these trusts (\$254,000 in 2008 and \$245,000 in 2007) are included in investment return used for operations in the consolidated statement of activities. Changes in fair value of the trusts are reported as increases or decreases in permanently restricted net assets.

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE E - PLEDGES RECEIVABLE - Continued

The Association used a risk-free interest rate of 3.75% and 4.36% to discount pledges receivable at August 31, 2008 and 2007, respectively.

The Association has ended a seven-year endowment campaign. During 2008 and 2007, contributions and cash collected on pledges receivable made to the endowment totaled \$7,613,000 and \$23,026,000 and campaign expenses incurred were \$750,000 and \$753,000, respectively.

NOTE F - PROPERTY AND EQUIPMENT

The components of property and equipment at August 31, are as follows:

	<u>2008</u>	<u>2007</u> (Restated)
Philadelphia Orchestra		
Office condominium	\$ 1,625,000	\$ 1,623,000
Building improvements	863,000	658,000
Equipment and other	4,629,000	3,786,000
Fine instruments	<u>295,000</u>	<u>295,000</u>
Total	7,412,000	6,362,000
Less accumulated depreciation	<u>(2,599,000)</u>	<u>(2,167,000)</u>
Total Philadelphia Orchestra	<u>4,813,000</u>	<u>4,195,000</u>
Academy of Music		
Land	\$ 630,000	\$ 630,000
Building and building improvements	63,977,000	63,304,000
Office equipment	851,000	840,000
Construction in progress	<u>1,972,000</u>	<u>-</u>
Total	67,430,000	64,774,000
Less accumulated depreciation	<u>(28,131,000)</u>	<u>(26,145,000)</u>
Total Academy of Music	<u>39,299,000</u>	<u>38,629,000</u>
Total property and equipment	<u>\$ 44,112,000</u>	<u>\$ 42,824,000</u>

Depreciation expense related to the Academy of Music is reflected in the Academy of Music expense on the statement of activities in the amount of \$1,985,000 and \$1,954,000 for the years ended August 31, 2008 and 2007, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS

The Association maintains separate noncontributory defined benefit plans covering members of the Orchestra and administrative employees. The Association makes annual contributions to the plans in consultation with the plan actuaries. Benefits for these plans are based on years of service and, for the administrative plan, most recent salary levels in the years preceding retirement.

The Association provides its employees with postretirement health care and, for former employees of the Academy who were union members, severance pay based on the number of years of employment.

Postretirement health insurance is provided to Association employees who retire generally with 10 years of service after age 50 for musicians and age 55 for staff. Postretirement health insurance is provided to former Academy employees who are members of the International Association of Theatrical Stage Employees Union, generally for employees who retire after age 62 and with 30 years of service. Premiums to be paid by the Association for these benefits are generally limited to \$2,000 per year for musicians and \$1,600 per year for all others.

The Academy also provided a severance benefit based on years of employment to retiring unionized box office employees ranging up to 15 or 20 years. At August 31, 2008 and 2007 the total severance pay benefit obligation was \$60,000 and \$63,000, respectively.

As part of the Association's Trade Agreement (the "Agreement") with the Philadelphia Musical Society, Local 77, American Federation of Musicians ("Local 77") that was in effect until September 16, 2007, Local 77 agreed to a freeze/curtailment of the defined benefit pension plan which covers all full-time musicians (the "Orchestra Plan"). The effective date of the curtailment was September 19, 2004. All credit for future service will be earned under the American Federation of Musicians' and Employers' Pension Plan (the "AFM Plan"). The Association contributes a specified percentage of minimum weekly salary for each full-time musician to the AFM Plan. The percentage of minimum weekly salary contributed in each contract year is 3.0% for fiscal year 2005, 5.0% for fiscal year 2006, and 7.5% for fiscal year 2007. A new trade agreement was signed on September 15, 2008 and covers three contract years ending on September 19, 2010. According to this agreement, the percentage of minimum weekly salary to be contributed for all years is 7.5%. In 2008 the AFM Plan's benefit multiplier decreased and as a result the effective contribution rate in 2008 was 8.08%. The Association contributed \$980,000 and \$891,000 in 2008 and 2007, respectively.

In addition to the contribution related to minimum weekly salary, the Association contributes to the AFM Plan for recording and broadcasting wages paid. At August 31, 2008 and 2007, the contributions were \$5,000 and \$21,000, respectively.

In connection with the Agreement, a Voluntary Retirement Incentive Program (the "VRIP") was offered to certain full-time musicians who would reach age 60 by June 30, 2005 with 30 years of service with the Orchestra. A total of 10 musicians agreed to accept the terms of the VRIP and retired at various dates prior to September 30, 2005. In connection with the VRIP, the annual pension benefit payment under the Orchestra Plan for these individuals was increased from \$55,000 to \$65,000. Additionally, these individuals will receive an annual bonus payment of \$5,000 for a period of not more than 6 years and, in some cases, the Association will pay the retiree's portion of any medical premium cost sharing. The Association recognized the costs for the VRIP and the additional annual

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

bonus in its August 31, 2005 financial statements. These costs totaled \$1,256,000, of which \$986,000 was included in pension plan curtailment costs, and \$270,000 was included in orchestra and concert production expenses, respectively. At August 31, 2008 and 2007, \$63,000 and \$113,000, respectively, related to the bonus is included in other liabilities in the consolidated statements of financial position.

In September 2006, the Association and the Members' Committee of Local 77 agreed to extend a Voluntary Retirement Incentive Program ("VRIP2") to certain full-time musicians who would reach age 60 by September 16, 2007 with 30 years of service with the Orchestra. A total of 3 musicians agreed to accept the terms of the VRIP2 and all retired as of September 16, 2007. In connection with the VRIP2, the total annual pension benefit payment was guaranteed to be \$65,000 from the combination of payments due under the Orchestra plan and payments due under the AFM plan for contributions made related to the members' minimum weekly salary payments. The Association recognized the cost for VRIP2 of \$259,000 in its August 31, 2007 consolidated financial statements in one-time special pension benefit expenses.

The Association uses June 30, 2008 and June 30, 2007 as the measurement dates for the following information:

	2008					
	Pension Plans		Other Postretirement Plans			Total
	Orchestra	Admin	Orchestra	Admin	Academy	
Projected benefit obligation, end of year	\$ 31,323,000	\$ 5,666,000	\$ 3,308,000	\$ 494,000	\$ 121,000	\$ 40,912,000
Fair value of plan assets, end of year	<u>26,209,000</u>	<u>4,855,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>31,064,000</u>
Funded status recognized in the statement of financial position	\$ <u>(5,114,000)</u>	\$ <u>(811,000)</u>	\$ <u>(3,308,000)</u>	\$ <u>(494,000)</u>	\$ <u>(121,000)</u>	\$ <u>(9,848,000)</u>
Current portion	\$ <u>-</u>	\$ <u>-</u>	\$ <u>(190,000)</u>	\$ <u>(20,000)</u>	\$ <u>(10,000)</u>	\$ <u>(220,000)</u>
Long-term portion	\$ <u>(5,114,000)</u>	\$ <u>(811,000)</u>	\$ <u>(3,118,000)</u>	\$ <u>(474,000)</u>	\$ <u>(111,000)</u>	\$ <u>(9,628,000)</u>
Assumptions						
Weighted-average assumptions, end of year						
Discount rate	6.97%	7.10%	6.74%	6.74%	6.74%	
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%	8.00%	
Rate of compensation increase	N/A	3.50%	N/A	N/A	N/A	

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

	2007					
	Pension Plans		Other Postretirement Plans			Total
	Orchestra	Admin	Orchestra	Admin	Academy	
Projected benefit obligation, end of year	\$ 32,739,000	\$ 6,165,000	\$ 3,546,000	\$ 500,000	\$ 134,000	\$ 43,084,000
Fair value of plan assets, end of year	<u>29,099,000</u>	<u>5,691,000</u>	_____	_____	_____	<u>34,790,000</u>
Funded status recognized in the statement of financial position	\$ <u>(3,640,000)</u>	\$ <u>(474,000)</u>	\$ <u>(3,546,000)</u>	\$ <u>(500,000)</u>	\$ <u>(134,000)</u>	\$ <u>(8,294,000)</u>
Current portion	\$ _____	\$ _____	\$ <u>(190,000)</u>	\$ <u>(20,000)</u>	\$ <u>(10,000)</u>	\$ <u>(220,000)</u>
Long-term portion	\$ <u>(3,640,000)</u>	\$ <u>(474,000)</u>	\$ <u>(3,356,000)</u>	\$ <u>(480,000)</u>	\$ <u>(124,000)</u>	\$ <u>(8,074,000)</u>
Assumptions						
Weighted-average assumptions, end of year						
Discount rate	6.25%	6.25%	6.25%	6.25%	6.25%	
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%	8.00%	
Rate of compensation increase	N/A	3.50%	N/A	N/A	N/A	

The following represents the unrecognized components of net periodic benefit cost included in unrestricted net assets at August 31, 2008 and 2007:

	2008					
	Pension Plans		Other Postretirement Plans			Total
	Orchestra	Admin	Orchestra	Admin	Academy	
Transition obligation	\$ -	\$ 38,000	\$ -	\$ -	\$ -	\$ 38,000
Prior service cost (credit)	-	(162,000)	221,000	37,000	0,000	106,000
Net gain (loss)	<u>(8,281,000)</u>	<u>43,000</u>	<u>(723,000)</u>	<u>(66,000)</u>	<u>(25,000)</u>	<u>(9,052,000)</u>
Amounts recorded in unrestricted net assets	\$ <u>(8,281,000)</u>	\$ <u>(81,000)</u>	\$ <u>(502,000)</u>	\$ <u>(29,000)</u>	\$ <u>(15,000)</u>	\$ <u>(8,908,000)</u>

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

	2007					
	Pension Plans		Other Postretirement Plans			Total
	Orchestra	Admin	Orchestra	Admin	Academy	
Transition obligation	\$ -	\$ 48,000	\$ -	\$ -	\$ -	\$ 48,000
Prior service cost (credit)	-	(173,000)	381,000	64,000	18,000	290,000
Net gain (loss)	<u>(5,856,000)</u>	<u>223,000</u>	<u>(1,239,000)</u>	<u>(117,000)</u>	<u>(39,000)</u>	<u>(7,028,000)</u>
Amounts recorded in unrestricted net assets	<u>\$ (5,856,000)</u>	<u>\$ 98,000</u>	<u>\$ (858,000)</u>	<u>\$ (53,000)</u>	<u>\$ (21,000)</u>	<u>\$ (6,690,000)</u>

For the defined benefit pension plans the estimated transition obligation (asset), actuarial (gain) loss and prior service cost (credit that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$(10,000), \$180,000 and \$11,000, respectively. For the defined benefit postretirement plans the estimated actuarial gain (loss) and prior service cost (credit) that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$45,000 and (\$195,000), respectively.

In determining the expected rate of return on plan assets, consideration was given to historical performance of the pension portfolios and allocation of the plan's assets. For the period ended June 30, 2008, the five-year return on the Orchestra and Administrative plans assets was 9.3% and 8.5%, respectively. Based on this historical return performance and the outlook for modestly lower future returns, management believes that no adjustment to the assumption on the expected rate of return on plan assets is warranted.

For measurement purposes, a 9% and 10% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2008 and 2007, respectively. The rate was assumed to decrease to a rate of 5% by various percentages yearly.

Net periodic benefit cost, contributions, and benefits paid are as follows for 2008 and 2007:

	2008					
	Pension Plans		Other Postretirement Plans			
	Orchestra	Administrative	Orchestra	Staff	Academy	
Benefit cost	\$ 249,000	\$ 158,000	\$ 256,000	\$ 39,000	\$ 2,000	
Employer contribution	1,200,000	-	137,000	21,000	9,000	
Plan participant's contributions	-	-	-	-	-	
Benefits paid	2,355,000	235,000	137,000	21,000	9,000	

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

	2007				
	Pension Plans		Other Postretirement Plans		
	Orchestra	Administrative	Orchestra	Staff	Academy
Benefit cost	\$ 750,000	\$ 147,000	\$ 273,000	\$ 42,000	\$ 3,000
Employer contribution	1,200,000	-	118,000	17,000	7,000
Plan participant's contributions	-	-	-	-	-
Benefits paid	2,293,000	228,000	118,000	17,000	7,000

1. Obligations and Funded Status

	2008		2007	
	Pension Plans		Pension Plans	
	Orchestra	Administrative	Orchestra	Administrative
Funded status at year end	\$ (5,114,000)	\$ (474,000)	\$ (3,640,000)	\$ (474,000)
Amounts recognized in the statement of financial position consist of				
Accrued Benefit Obligations	(5,114,000)	(811,000)	(3,640,000)	(474,000)
Unrestricted Net Assets	<u>8,281,000</u>	<u>81,000</u>	<u>5,856,000</u>	<u>(98,000)</u>
Net amount recognized at year-end	<u>\$ (3,167,000)</u>	<u>\$ (730,000)</u>	<u>\$ 2,216,000</u>	<u>\$ (572,000)</u>

	2008		2007	
	Pension Plans		Pension Plans	
	Orchestra	Administrative	Orchestra	Administrative
Additional information for pension plans with accumulated benefit obligations in excess of plan assets				
Projected benefit obligation	<u>\$ 31,323,000</u>	<u>\$ 5,666,000</u>	<u>\$ 32,739,000</u>	<u>\$ 6,166,000</u>
Accumulated benefit obligation	<u>\$ 31,323,000</u>	<u>\$ 5,441,000</u>	<u>\$ 32,739,000</u>	<u>\$ 5,830,000</u>
Fair value of plan assets	<u>\$ 26,209,000</u>	<u>\$ 4,855,000</u>	<u>\$ 29,099,000</u>	<u>\$ 5,691,000</u>

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

2. Plan Assets

The Association's weighted average asset allocation for the Orchestra and Administrative pension plans as of June 30, 2008 and 2007 (plan measurement date) by asset category are as follows:

	<u>2008</u>	<u>2007</u>
Asset category		
Equity securities	64%	64%
Debt securities	34	34
Other	<u>2</u>	<u>2</u>
Total	<u>100%</u>	<u>100%</u>

The Association maintains an investment policy for its plan assets. The long-term total return objective is to meet annual inflation plus 5% per year. During fiscal year 2007, the Association revised the asset allocation for the Orchestra pension plan due to the frozen nature of the plan to provide a better match to the liabilities of the plan. The target asset allocation for the Orchestra plan was revised to 40% Domestic Long-duration Fixed-Income, 37% U.S. Large Cap Equity, 9% U.S. Small Cap Equity and 14% International Equity. The target asset allocation for the administrative pension plan is 47% U.S. Large Cap Equity, 25% Core Domestic Fixed-Income, 18% International Equity and 10% U.S. Small Cap Equity. Each class may be invested in mutual funds, commingled funds, or individually managed accounts. Funds may not be invested in real estate, partnerships, currency hedging, individual businesses, direct investments, or start-up funds. Performance of asset managers is evaluated quarterly by management and the Investment Committee of the Association's Board to test progress toward long-term goals.

3. Cash Flows

Estimated future benefit payments for years ending after August 31, 2008 as of the plan valuation date of June 30, 2008 are as follows:

Pension

<u>Years ending August 31,</u>	<u>Orchestra</u>	<u>Administrative</u>
2009	\$ 2,400,000	\$ 290,000
2010	2,400,000	300,000
2011	2,400,000	300,000
2012	2,400,000	290,000
2013	2,500,000	320,000
2014-2018	12,300,000	1,840,000

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE G - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

Postretirement

<u>Years ending August 31,</u>	<u>Orchestra</u>	<u>Administrative</u>	<u>Academy</u>
2009	\$ 190,000	\$ 20,000	\$ 10,000
2010	200,000	20,000	10,000
2011	200,000	30,000	10,000
2012	200,000	30,000	10,000
2013	220,000	40,000	10,000
2014-2018	1,190,000	270,000	50,000

4. Contributions

The Association expects to contribute at least the minimum amount required by law to the Pension plans.

NOTE H - BONDS PAYABLE AND LINE OF CREDIT

On September 1, 1998, the Academy entered into a loan agreement with the Philadelphia Authority for Industrial Development ("PAID") for the financing of various capital improvements and renovations of the Academy of Music building and paying portion of the costs associated with the bond issuance. Pursuant to the terms of the loan agreement, PAID issued \$6,500,000 Variable Rate Revenue Bonds (The Academy of Music of Philadelphia Project) - Series 1998 due September 1, 2018. The bonds bear interest at a variable rate (determined based on the current weekly rate) which was 1.8% as of August 31, 2008 and 4.0% as of August 31, 2007, not to exceed 12.0% per year. The Academy has the option to convert to a term interest rate not to exceed 25.0% per year. The bonds are principally secured by a letter of credit between a bank and the trustee. The trustee is requested to draw upon the letter of credit to (a) make timely payment of principal and interest on the bonds; (b) make timely payment of bonds called for optional redemption and (c) make timely payments of bonds required to be purchased as a result of a permitted or required tender. In connection with the letter of credit agreement, the Academy has entered into a reimbursement agreement with a bank under which the Academy will reimburse the bank for each drawing under the letter of credit. The bonds are secured by a pledge of assets held under a Letter of Credit grant by a global financial institution. This agreement requires the Association to maintain certain financial ratios and, among other things, limits additional indebtedness and the disposition of certain property. The letter of credit Agreement expires on April 30, 2009. If amounts are outstanding under the Letter Of Credit Agreement due to a failed

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE H - LOAN PAYABLE AND LINE OF CREDIT - Continued

remarketing the amount outstanding is due on demand by the financial institution. No amounts are outstanding under the letter of credit at August 31, 2008. If there are no amounts outstanding on the Letter of Credit the bonds have a scheduled maturity as follows:

2009	\$ 300,000
2010	400,000
2011	400,000
2012	400,000
2013	400,000
Thereafter	<u>1,300,000</u>
Total	<u>\$ 3,200,000</u>

The Association has available a \$10,000,000 revolving credit facility. Under the agreement with the bank, the interest rate is, at the option of the Association, the London Interbank Offering Rate ("LIBOR") plus 0.9%, or the prime rate minus 1.00%. The rate at August 31, 2008 and 2007 was 3.6% and 6.3%, respectively, based on LIBOR. The facility is available for working capital and general corporate purposes. This agreement also requires the Association to maintain certain financial ratios and, among other things, limit additional indebtedness and the disposition of certain property. At August 31, 2008 and 2007, the Association had borrowings outstanding of \$8,000,000 and \$7,300,000, respectively, under the line of credit to meet interim working capital needs. This line of credit expires June 1, 2009.

NOTE I - NET ASSETS

Temporarily restricted net assets consist of the following at August 31,:

	<u>2008</u>	<u>2007</u> (As restated)
Time and purpose restricted contributions	\$ 4,335,000	\$ 3,026,000
Investment gains and losses	<u>17,615,000</u>	<u>38,976,000</u>
	<u>\$ 21,950,000</u>	<u>\$ 42,002,000</u>

Permanently restricted net assets consist of the following at August 31,:

	<u>2008</u>	<u>2007</u> (As restated)
Third party trust assets	\$ 4,436,000	\$ 4,992,000
Pledges related to the endowment	7,938,000	8,743,000
Investments - principal	<u>128,028,000</u>	<u>124,425,000</u>
	<u>\$ 140,402,000</u>	<u>\$ 138,160,000</u>

(Continued)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE I - NET ASSETS - Continued

During fiscal year 2008, the Association determined that certain endowment balances comprising its permanently restricted net assets at August 31, 2008 had market values less than their historical corpus values. Aggregate shortfalls amounted to \$3,715,000. As of August 31, 2008, there was a total of 129 individual endowment funds within the permanently restricted net assets category with market values less than their historical corpus values.

NOTE J - JOINT VENTURE

On July 1, 2001, the Association invested \$70,000 in a nonprofit joint venture. The joint venture, ("Ticket Philadelphia"), was entered into along with KCI to handle all aspects of the ticketing function for all events held at the Academy of Music, Kimmel Center, and other venues in the Philadelphia area. This venture replaced the Association's ticketing operations. Operating results are to be shared in accordance with a formula agreed to by the parties. The Association is using the equity method of accounting to account for its share of the joint venture's activity. At August 31, 2008 and 2007, the Association's interest in the net assets of the joint venture was \$575,000. During the years ended August 31, 2008 and 2007, the Association received a payment of \$187,000 and \$341,000, respectively, from Ticket Philadelphia for its share of profits from Ticket Philadelphia's fiscal year 2008 and 2007 operations.

NOTE K - ANNENBERG FOUNDATION PLEDGES

The Annenberg Foundation (the "Foundation") and the Orchestra entered into an agreement dated September 15, 2003, under which the Foundation agreed to make a grant to the Orchestra's Endowment in the amount of \$50,000,000. This grant was restricted to establish funds for Education (\$15,000,000), Touring (\$15,000,000), Media & Technology (\$10,000,000) and Artistic Endeavors (\$10,000,000). The final payment of the grant was received in October 2006. In conjunction with the grant agreement, the Orchestra has agreed to maintain a balanced annual budget and operating results (as defined) for fiscal years beginning after August 31, 2005 along with a reduction in the annual spending rate of endowment earnings allocated to operations to not more than 5.5% for fiscal years ending after June 30, 2008. The Orchestra did not meet the criteria of balanced budget operating results for fiscal 2008 and obtained a waiver from the Foundation.

The Annenberg Foundation (the "Foundation"), the Orchestra and the Academy entered into an agreement dated January 30, 2004, under which the Foundation agreed to make a grant to the Academy's Endowment in the amount of \$15,000,000. This grant was restricted to establish a source of funds for capital improvements to the Academy building. The funds related to this grant were all received as of May 2006.

The spending rate on these endowment funds is limited to 5.5% annually.

NOTE L - NEUBAUER FAMILY CHALLENGE GRANT

In a letter dated January 6, 2005, The Pew Charitable Trusts (the "Trust") advised the Association that it had approved the recommendation of Mr. Joseph Neubauer, former chairman of the Association's Board of Directors, that the Trust make a grant of up to \$10,000,000 from the Neubauer Family Donor-Advised Fund (the "DAF") to the Association's endowment. The grant, to be known as the Neubauer Family Challenge (the "Grant")

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE L - NEUBAUER FAMILY CHALLENGE GRANT - Continued

established funds for Artistic Innovation (\$5,000,000), Audience Development, Media and Technology (\$3,500,000), and to endow the Principal Trombone Chair (\$1,500,000). The full Grant amount is to be paid in five annual installments of \$2,000,000 beginning with the fiscal year ending August 31, 2005. Years 1-4 of the grant payment were received upon the Association meeting certain conditions described in the agreement.

As more fully explained in Note B19(a), the correction of previously recorded funding from the Commonwealth of Pennsylvania prompted a restatement of the Association's financial results for fiscal year 2007. This restatement caused the Association to, retrospectively, be in a condition of non-compliance with the budget challenge language contained in the Grant. The Association received a waiver from the Trust regarding non-compliance with the budget challenge requirement for fiscal year 2007 attributable to the aforementioned restatement.

The Association recorded a loss from operations in fiscal year 2008 and was not able to obtain a waiver from the Trust of the requirement. As such the Association has not recorded the final pledge receivable of \$2,000,000 related to the budget challenge for the fiscal year ended August 31, 2008.

NOTE M - ENCORE SERIES, INC.

On August 24, 2005, the Association entered into an agreement (the "Agreement") with Encore Services, Inc. ("ESI") and Peter Nero ("Nero") to combine their efforts to produce and promote concerts by Peter Nero and the Philly Pops (the "Pops"), in order to leverage artistic and administrative economies of scale for their mutual organizational and financial benefit. The Agreement provides that until at least June 30, 2010, ESI is to remain a separate 501(c)(3) organization with a separate board of directors. On July 1, 2010, at the sole discretion of the Association, ESI shall either cause its board of directors to consist of only those persons designated by the Association or take all such actions as are necessary to make the Association the sole member of ESI. The Agreement further provides that management of the Association will also serve as management of ESI beginning September 1, 2005. The Association has assumed financial responsibility and benefit for operation of ESI as of September 1, 2005 and until July 1, 2010. In the event that ESI has insufficient funds to pay its expenses, the Association shall advance funds to ESI. ESI required an advance for cash flow needs of \$50,000 during the 2008 fiscal year. The Association did not exercise control over ESI for the year ended August 31, 2008 and 2007.

Effective August 31, 2005, ESI is required to pay the Association for the cost of the services rendered by employees of the Association to ESI and any direct expenses of ESI paid by the Association. For fiscal years 2008 and 2007, these payments totaled \$330,000 and \$328,000, respectively, and are recorded as expenses on ESI's financial statements for the year ended June 30, 2008 and 2007.

Under the Agreement, ESI is required to pay the Association any surplus earnings. The Association is required to fund any deficit in operations. As of August 31, 2008, the Association has recorded a liability in the amount of \$246,000, ESI's change in net assets prior to the deficit transfer for the year ended June 30, 2008. The Orchestra received a payment of \$420,000 for the receivable recorded as of August 31, 2007.

(Continued)

The Philadelphia Orchestra Association

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2008 and 2007

NOTE M - ENCORE SERIES, INC. - Continued

The Association agreed to guarantee all of ESI's obligations under the existing contracts between ESI and Finger Prince, Inc. ("FPI") and Peter Nero. Those obligations include trade mark names, a recording contract and a contract for the services of Peter Nero as Music Director. The Association has never been required to make a payment under these obligations.

The following information represents a condensed statement of financial position and statement of activities information for ESI as of and for the years ended June 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Total Assets	\$ <u>1,599,000</u>	\$ <u>2,052,000</u>
Total Liabilities	\$ <u>1,732,000</u>	\$ <u>2,185,000</u>
Net Deficit	\$ <u>(133,000)</u>	\$ <u>(133,000)</u>
Total Revenues	\$ <u>4,098,000</u>	\$ <u>4,291,000</u>
Total Expenses	\$ <u>4,344,000</u>	\$ <u>3,871,000</u>
(Decrease) increase in net assets before net deficit transfer	\$ <u>(246,000)</u>	\$ <u>420,000</u>

NOTE N - CONTINGENCIES

The Association is subject to various claims and legal proceedings arising out of the ordinary course of business. Management believes the resolution of claims and pending litigation will not have a material effect, individually or in the aggregate, on the consolidated financial position of the Association.

NOTE O - COMMITMENTS

The Association has several commitments under contract for renovations of the Academy of Music. Portions of these contracts not completed at year-end are not reflected in the consolidated financial statements. This unrecorded commitment was approximately \$6,700,000 at August 31, 2008.

NOTE P - RELATED PARTY

The Orchestra and the Kimmel Center, in an effort to leverage economies of scale to capitalize on the strength inherent in larger human resource and information technology service models, have entered into an agreement whereby a single, integrated human resources staff provides human resource services to each organization according to their respective business needs. Allocable costs are charged to the Kimmel Center by the Orchestra pursuant to the aforementioned agreement. A similar arrangement governing a shared information technology department has been implemented as well.

For fiscal years 2008 and 2007, the Orchestra received payments from the Kimmel Center and Ticket Philadelphia totaling \$1,058,000 and \$799,000, respectively, for these services and is recorded in the consolidated statements of activities.