

**ALLIED ARTS OF
GREATER CHATTANOOGA**

FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

ALLIED ARTS OF GREATER CHATTANOOGA

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INDEPENDENT AUDITOR'S REPORT

Board of Directors of
Allied Arts of Greater Chattanooga
Chattanooga, Tennessee

We have audited the accompanying statements of financial position of Allied Arts of Greater Chattanooga (a Tennessee nonprofit corporation) as of June 30, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide 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 Allied Arts of Greater Chattanooga as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The data contained in the supplemental schedules of this report is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Chattanooga, Tennessee
October 13, 2011

*Henderson Hutcherson
is McCullough, PLLC*

ALLIED ARTS OF GREATER CHATTANOOGA

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2011 AND 2010

	ASSETS	
	2011	2010
Cash and cash equivalents	\$ 400,994	\$ 342,945
Restricted cash	71,211	71,792
Investments, at fair value	13,189,582	11,804,478
Receivables:		
Current sustaining fund campaign pledges	448,349	594,019
Campaign pledges	-	30,891
Government grants receivable	15,000	-
Other accounts receivable	87	579
Allowance for uncollectible pledges and other receivables	<u>(22,000)</u>	<u>(24,000)</u>
Total receivables, net	441,436	601,489
Prepaid and other assets	15,828	50,861
Equipment and furnishings, at cost, less accumulated depreciation of \$46,655 and \$115,224, respectively	<u>10,801</u>	<u>17,895</u>
TOTAL ASSETS	<u>\$ 14,129,852</u>	<u>\$ 12,889,460</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable	\$ 4,036	\$ 12,457
Accrued expenses	12,029	10,110
Deferred revenue	<u>-</u>	<u>79,000</u>
Total liabilities	<u>16,065</u>	<u>101,567</u>
NET ASSETS		
Unrestricted and board-designated	1,871,509	1,576,257
Temporarily restricted	3,994,860	2,964,218
Permanently restricted	<u>8,247,418</u>	<u>8,247,418</u>
Total net assets	<u>14,113,787</u>	<u>12,787,893</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 14,129,852</u>	<u>\$ 12,889,460</u>

ALLIED ARTS OF GREATER CHATTANOOGA

STATEMENTS OF ACTIVITIES

YEAR ENDED JUNE 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT				
Contributions	\$ 35,735	\$ 1,135,248	\$ -	\$ 1,170,983
Grants from governmental agencies	495,135	43,500	-	538,635
County fair revenues	104,618	-	-	104,618
Dividend and interest income	4,572	31,749	-	36,321
Donations in-kind	18,505	-	-	18,505
Other income	98,545	-	-	98,545
Net realized and unrealized gains (losses) on investments	<u>272,753</u>	<u>1,910,610</u>	<u>-</u>	<u>2,183,363</u>
Total revenues, gains, and other support	1,029,863	3,121,107	-	4,150,970
NET ASSETS RELEASED FROM RESTRICTIONS	2,090,465	(2,090,465)	-	-
EXPENSES				
Programs:				
Agency allocations and grants	1,457,768	-	-	1,457,768
Investment income distributed to member agencies	239,541	-	-	239,541
County fair expenses	103,863	-	-	103,863
Art education	200,128	-	-	200,128
Events and special projects	263,506	-	-	263,506
Marketing expense	49,202	-	-	49,202
Operating expenses	477,650	-	-	477,650
Other expenses	<u>33,418</u>	<u>-</u>	<u>-</u>	<u>33,418</u>
Total expenses	<u>2,825,076</u>	<u>-</u>	<u>-</u>	<u>2,825,076</u>
NET CHANGE IN NET ASSETS	<u>295,252</u>	<u>1,030,642</u>	<u>-</u>	<u>1,325,894</u>
Net assets - beginning of year	<u>1,576,257</u>	<u>2,964,218</u>	<u>8,247,418</u>	<u>12,787,893</u>
Net assets - end of year	<u>\$ 1,871,509</u>	<u>\$ 3,994,860</u>	<u>\$ 8,247,418</u>	<u>\$ 14,113,787</u>

ALLIED ARTS OF GREATER CHATTANOOGA

STATEMENTS OF ACTIVITIES

YEAR ENDED JUNE 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT				
Contributions	\$ 65,885	\$ 1,359,970	\$ -	\$ 1,425,855
Grants from governmental agencies	628,602	-	-	628,602
County fair revenues	100,250	-	-	100,250
Dividend and interest income	392	47,223	-	47,615
Donations in-kind	39,340	-	-	39,340
Other income	6,575	-	-	6,575
Net realized and unrealized gains (losses) on investments	<u>277,099</u>	<u>1,256,862</u>	<u>-</u>	<u>1,533,961</u>
Total revenues, gains, and other support	1,118,143	2,664,055	-	3,782,198
NET ASSETS RELEASED FROM RESTRICTIONS	2,024,358	(2,024,358)	-	-
EXPENSES				
Programs:				
Agency allocations and grants	1,492,724	-	-	1,492,724
Investment income distributed to member agencies	252,186	-	-	252,186
County fair expenses	112,586	-	-	112,586
Art education	171,949	-	-	171,949
Events and special projects	182,756	-	-	182,756
Marketing expense	121,533	-	-	121,533
Operating expenses	452,310	-	-	452,310
Other expenses	<u>36,924</u>	<u>-</u>	<u>-</u>	<u>36,924</u>
Total expenses	<u>2,822,968</u>	<u>-</u>	<u>-</u>	<u>2,822,968</u>
NET CHANGE IN NET ASSETS	<u>319,533</u>	<u>639,697</u>	<u>-</u>	<u>959,230</u>
Net assets - beginning of year	<u>1,256,724</u>	<u>2,324,521</u>	<u>8,247,418</u>	<u>11,828,663</u>
Net assets - end of year	<u>\$ 1,576,257</u>	<u>\$ 2,964,218</u>	<u>\$ 8,247,418</u>	<u>\$ 12,787,893</u>

The accompanying notes are an integral part of the financial statements.

ALLIED ARTS OF GREATER CHATTANOOGA

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	\$ 1,325,894	\$ 959,230
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Realized and unrealized gains on investments	(2,183,363)	(1,533,961)
Depreciation	11,259	16,206
Changes in assets and liabilities:		
Decrease (increase) in receivables	160,053	(114,808)
Decrease (increase) in prepaid and other assets	35,033	(39,310)
(Decrease) increase in accounts payable and accrued liabilities	(85,502)	82,710
Net cash used by operating activities	<u>(736,626)</u>	<u>(629,933)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of investments	2,320,235	2,533,662
Reinvested dividends and interest from investments	(36,281)	(47,223)
Purchase of investments	(1,485,695)	(1,660,492)
Purchase of equipment and furnishings	(4,165)	(984)
Net cash provided by investing activities	<u>794,094</u>	<u>824,963</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	57,468	195,030
Cash and cash equivalents - beginning of year	<u>414,737</u>	<u>219,707</u>
Cash and cash equivalents - end of year	<u>\$ 472,205</u>	<u>\$ 414,737</u>

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 1 – NATURE OF OPERATIONS

Allied Arts of Greater Chattanooga (“Allied Arts” or the “Organization”) provides annual operating support to sixteen cultural organizations and funding of various arts and cultural activities through its Arts Build Communities and Arts Education programs.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Support and Expenses

Contributions received and unconditional promises to give are measured at their fair values and are reported as an increase in net assets. Allied Arts reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designed as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activity as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

Expenses, including member agency allocations, investment income distributions, and operating and fundraising expenditures are recorded when incurred in accordance with the accrual basis of accounting.

Cash and Cash Equivalents

For purposes of cash flows, all investment instruments purchased with a maturity of three months or less are considered to be cash equivalents.

Restricted Cash

Restricted cash represents funds that must be used for a specific purpose. As of June 30, 2011 and 2010, restricted cash consisted of the following:

	2011	2010
Native American funds	\$ -	\$ 1,375
County fair funds	<u>71,211</u>	<u>70,417</u>
Total restricted cash	<u>\$71,211</u>	<u>\$71,792</u>

Contingent Risk Regarding Cash Balances

The Organization maintains cash balances at various financial institutions, whose accounts are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Organization's balance on deposit at the banks may exceed \$250,000 from time to time throughout the year.

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Promises to Give

Unconditional promises to give expected to be collected within one year are recorded at net realizable value. Unconditional promises to give expected to be collected in more than one year are discounted to their estimated present value.

Investments

The Organization has adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820 *Fair Value Measurement*. ASC Topic 820 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value, and enhances disclosure requirements for fair value measurements. ASC Topic 820 maximizes the use of observable inputs and minimized the use of unobservable inputs by requiring that the observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of June 30. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of June 30. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.

Level 3 – Securities that have little to no pricing observability as of June 30. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Investments in private investment entities are valued based on the Organization's proportional share of the net asset valuations reported by the underlying entities. The investments are classified in Level 2 or 3 of the fair value hierarchy as specified in Accounting Standards Update, *Fair Value Measurements and Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share*.

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments (Continued)

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Organization. The Organization considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Organization's perceived risk of that instrument.

Property and Equipment

Expenditures for property and equipment greater than \$500 are capitalized at original cost. Depreciation is computed over the estimated useful life of each asset using the straight-line method. Leasehold improvements are depreciated using the 7-year declining balance method and are capitalized at the original cost of the improvement.

Endowment

The Organization accounts for its endowment funds in accordance with FASB issued Staff Position (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 117-1), which provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organization's endowment funds.

Advertising Costs

Advertising costs are expensed as incurred. Total advertising expense was \$27,911 and \$85,329 for the years ended June 30, 2011 and 2010, respectively.

Contributed Services

A substantial number of volunteers have donated significant amounts of their time to Allied Arts. As these services do not create or enhance non-financial assets or require specialized skills, the donated services are not reflected in the accompanying financial statements.

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Uses of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates, although, in the opinion of management, such differences would not be significant.

Concentrations

The Organization receives the majority of its contributions from residents of Hamilton County and surrounding areas, and as such can be subject to the economic fluctuations of that area.

Income Taxes

Allied Arts is a nonprofit organization whose revenue is derived principally from contributions, grants, and other fundraising activities, and is not subject to federal or state income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been included in the Organization's financial statements.

The Organization adopted the provisions of FASB ASC Topic 740 relative to accounting for uncertainty in income taxes. No such uncertainties have been identified by management which require disclosure in the financial statements.

NOTE 3 – INVESTMENTS

As stated in Note 2, the Organization accounts for its investments in securities according to the provisions of ASC Topic 820. A summary of the inputs used to value the Organization's investments as of June 30, 2011 and 2010, is as follows:

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 3 – INVESTMENTS (Continued)

		Fair Value Measurements at Reporting Date Using		
June 30, 2011	Total	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	\$ 89,328	\$ 89,328	\$ -	\$ -
Fixed income	844,496	431,676	412,820	-
Hedge funds	5,183,055	-	5,183,055	-
Real estate partnerships	292,564	-	-	292,564
Private equity	3,707,312	-	2,448,861	1,258,451
International equity	2,057,991	-	2,057,991	-
Emerging markets	<u>1,014,836</u>	<u>-</u>	<u>1,014,836</u>	<u>-</u>
Total	<u>\$13,189,582</u>	<u>\$521,004</u>	<u>\$11,117,563</u>	<u>\$1,551,015</u>

		Fair Value Measurements at Reporting Date Using		
June 30, 2010	Total	Quoted Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and equivalents	\$76,448	\$ 76,448	\$ -	\$ -
Fixed income	964,503	578,622	385,881	-
Hedge funds	4,548,915	-	4,548,915	-
Real estate partnerships	1,034,043	-	886,766	147,277
Private equities	2,750,798	-	1,886,400	864,398
International equities	1,543,220	-	1,543,220	-
Emerging markets	<u>886,551</u>	<u>-</u>	<u>886,551</u>	<u>-</u>
Total	<u>\$11,804,478</u>	<u>\$655,070</u>	<u>\$10,137,733</u>	<u>\$1,011,675</u>

The inputs used in the determination of fair value require significant management judgment or estimation. A reconciliation of investments in which significant unobservable inputs (Level 3) were used in determining fair value is as follows:

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 3 – INVESTMENTS (Continued)

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	2011	2010
Beginning balance	\$1,011,675	\$9,878,853
Transfers out of Level 3	-	(9,154,727)
Purchases of securities	279,000	180,000
Distributions	(20,312)	(43,543)
Total gains or loss (realized/unrealized) included in changes in net assets	<u>280,652</u>	<u>151,092</u>
Ending balance	<u>\$1,551,015</u>	<u>\$1,011,675</u>

The amount of total gains for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date were \$1,083,919.

Transfers out of Level 3 resulted from the implementation of the Accounting Standards Update, *Fair Value Measurements and Disclosure for Investments in Certain Entities that Calculate Net Asset Value per Share*, which was effective for periods ending after December 15, 2009. The Update permits Level 2 classification for certain investments when the Organization has the ability to redeem its investment at the net asset value as of the measurement date or in the near term. Accordingly, certain of the Organization's investments previously classified using Level 3 inputs have been transferred to Level 2 classification of the fair value hierarchy.

The Organization invests in certain entities that calculate net asset value per share (or its equivalent). The following is a summary of such investments for the year ended June 30, 2011:

	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Fixed income ^a	\$ 412,820	\$ -	Monthly	N/A
Hedge funds ^b	5,183,055	-	Annually	90 days
Real estate partnerships ^c	292,564	385,000	Quarterly	45 days
Private equity ^d	3,707,312	616,000	N/A	N/A
International equity ^e	2,057,991	-	Quarterly	90 days
Emerging markets ^f	1,014,836	-	Annually	90 days
Other investments – not reported at net asset value per share	<u>521,004</u>	<u>-</u>	N/A	N/A
Total	<u>\$13,189,582</u>	<u>\$1,001,000</u>		

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 3 – INVESTMENTS (Continued)

^a – This category includes investments in an investment partnership bond fund whose objective is to maximize returns through investments in closed-end funds that invest primarily in fixed income securities, including corporate bonds. The fair values of the investments in this category have been estimated using the net asset value per share of the investments. Withdrawals can only be made on the first business day after valuation of the fund.

^b – This category includes investments in an investment partnership which is organized as a “fund of funds” and primarily invests in other privately-managed investment vehicles. The general partner of the underlying fund has complete discretion as to investment and reinvestment of the partnership’s assets. The Organization may withdraw only at the end of a calendar year by giving notice no later than September 30 of that year unless otherwise permitted by the general partner.

^c – This category includes investments in an investment partnership, whose purpose is to pool and invest funds contributed by the members in real property or interests therein, either directly or through investments in other entities that hold interests in real property. The fair values of the investments in this category have been estimated using the net asset value per share of the investments. Due to ongoing capital call requirements, 100% of the investments in this category are not currently redeemable.

^d – This category includes investments in funds of funds which invest in various private equity funds. The fair values of the investments in this category have been estimated using the net asset value per share of the investments. Due to ongoing capital call requirements, 33.95% of the investments in this category are not currently redeemable. The remaining 66.05% of the investments in this category do not have redemptions to the extent of capital contributions, with distributions made pursuant to the partnership agreement.

^e – This category includes investments in an investment partnership that takes primarily long positions in a broad range of international and domestic equity securities to achieve long-term performance over a designated long-only index. The fair values of the investments in this category have been estimated using the net asset value per share of the investments.

^f – This category includes investments in an investment partnership which is organized as a “fund of funds” and invests in limited partnerships, open-end mutual funds, closed-end mutual funds, trust funds and separately managed accounts that invest in equity and debt securities in developed and developing economies on a global basis. The fair values of the investments in this category have been estimated using the net asset value per share of the investments.

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 4 – PLEDGES RECEIVABLE

Unconditional promises to give due in more than one year are reflected at the present value of estimated future cash flows using a discount rate equal to the average prime rate. There were no pledges due to be received in greater than one year as of June 30, 2011 and 2010, therefore no discount was reflected for the years then ended.

NOTE 5 – PROPERTY AND EQUIPMENT

Equipment and furnishings consisted of the following at June 30, 2011 and 2010:

	2011	2010
Leasehold improvements	\$ 37,807	\$ 102,552
Computers and equipment	15,019	27,869
Furniture and fixtures	<u>4,630</u>	<u>2,698</u>
	57,456	133,119
Less accumulated depreciation	<u>(46,655)</u>	<u>(115,224)</u>
Net property and equipment	<u>\$ 10,801</u>	<u>\$ 17,895</u>

Depreciation expense for the years ended June 30, 2011 and 2010 was \$11,259 and \$16,206, respectively.

NOTE 6 – ENDOWMENTS

The Organization's endowment consists of donor-restricted contributions to be held in perpetuity, the income from which is expendable first to provide support to the Chattanooga Symphony and Opera Association (“CSOA”) and the Hunter Museum of Art (“Hunter”). Investment income earned on endowment assets in excess of amounts distributed to the CSOA and the Hunter is unrestricted as to purpose.

Interpretation of Relevant Law

The Board of Directors of the Organization has interpreted the State of Tennessee's Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

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ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 6 – ENDOWMENTS (Continued)

In accordance with UPMIFA, the Organization considers the following facts in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization

Return Objectives and Risk Parameters

The primary financial objective of the endowment is to provide funds for the current and future support of the operation of the Organization. The fund's performance objective is to maximize total return consistent with a prudent level of risk to ensure long-term growth.

Strategies Employed for Achieving Objectives

The Board of Directors believes the most prudent way to minimize volatility of the total portfolio without foregoing significant investment return is through a program of broad diversification. Central to the achievement of this goal is the concept of investing in asset classes that demonstrate relatively low correlation to one another. These correlations and their total impact on the total portfolio will be reviewed on an annual basis by the Board's investment committee to determine the effectiveness of the diversification program.

Spending Policy and How the Investment Objectives Relate to the Spending Policy

The Organization has a policy of appropriating for distribution each year 5 percent of its endowment fund's average fair value over the prior 36 months through the fiscal year-end preceding the fiscal year in which the distribution is planned, subject to approval of the Board of Directors. Accordingly, over the long term, the Organization expects its endowment to grow at an average rate that is in excess of its 5 percent appropriation. This is consistent with the Organization's objective of long-term growth of the endowment fund.

To satisfy its objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 6 – ENDOWMENTS (Continued)

Funds with Deficiencies

From time to time, the fair value of assets associated with donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. There are no such deficiencies.

Endowment Net Asset Composition by Type of Fund as of June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 2,816,112	\$ 8,247,418	\$ 11,063,530
Board-designated endowment funds	<u>1,561,586</u>	<u>-</u>	<u>-</u>	<u>1,561,586</u>
Total funds	<u>\$1,561,586</u>	<u>\$ 2,816,112</u>	<u>\$ 8,247,418</u>	<u>\$ 12,625,116</u>

Changes in Endowment Net Assets for the Fiscal Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$1,389,721	\$1,602,873	\$8,247,418	\$11,240,012
Investment return:				
Dividends and interest	4,532	31,749	-	36,281
Appreciation (realized and unrealized), net of investment expenses	<u>272,753</u>	<u>1,910,610</u>	<u>-</u>	<u>2,183,363</u>
Total investment return	277,285	1,942,359	-	2,219,644
Appropriation of endowment assets for expenditure	<u>(105,420)</u>	<u>(729,120)</u>	<u>-</u>	<u>(834,540)</u>
Endowment net assets, end of year	<u>\$1,561,586</u>	<u>\$2,816,112</u>	<u>\$8,247,418</u>	<u>\$12,625,116</u>

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 6 – ENDOWMENTS (Continued)

**Endowment Net Asset Composition by Type of Fund
as of June 30, 2010**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 1,602,873	\$ 8,247,418	\$ 9,850,291
Board-designated endowment funds	<u>1,389,721</u>	<u>-</u>	<u>-</u>	<u>1,389,721</u>
Total funds	<u>\$ 1,389,721</u>	<u>\$ 1,602,873</u>	<u>\$ 8,247,418</u>	<u>\$ 11,240,012</u>

**Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 2010**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 1,223,607	\$ 1,060,974	\$ 8,247,418	\$ 10,531,999
Investment return:				
Dividends and interest	-	47,223	-	47,223
Depreciation (realized and unrealized), net of investment expenses	<u>277,099</u>	<u>1,256,862</u>	<u>-</u>	<u>1,533,961</u>
Total investment return	277,099	1,304,085	-	1,581,184
Appropriation of endowment assets for expenditure	<u>(110,985)</u>	<u>(762,186)</u>	<u>-</u>	<u>(873,171)</u>
Endowment net assets, end of year	<u>\$ 1,389,721</u>	<u>\$ 1,602,873</u>	<u>\$ 8,247,418</u>	<u>\$ 11,240,012</u>

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 6 – ENDOWMENTS (Continued)

Description of Amounts Classified as Permanently Restricted and Temporarily Restricted Net Assets (Endowment Only)

Permanently Restricted Net Assets	2011	2010
The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA	<u>\$8,247,418</u>	<u>\$8,247,418</u>
Total endowment funds classified as permanently restricted net assets	<u>\$8,247,418</u>	<u>\$8,247,418</u>
Temporarily Restricted Net Assets	2011	2010
Term endowment funds	\$ -	\$ -
The portion of perpetual endowment funds subject to a time restriction under UPMIFA:		
Without purpose restrictions	2,816,112	1,602,873
With purpose restrictions	<u>-</u>	<u>-</u>
Total endowment funds classified as temporarily restricted net assets	<u>\$2,816,112</u>	<u>\$1,602,873</u>

NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for use in future periods. In addition to endowment earnings which have not been appropriated for expenditure as described in Note 6, the remaining portion of temporarily restricted net assets consisted of pledges due in future periods and contributions received whose purpose restrictions have not been fulfilled.

	2011	2010
Endowment earnings subject to a time restriction	\$2,816,112	\$1,602,873
Contributions subject to a purpose restriction	103,500	188,163
Contributions subject to a time restriction	<u>1,075,248</u>	<u>1,173,182</u>
	<u>\$3,994,860</u>	<u>\$2,964,218</u>

NOTE 8 – NET ASSETS RELEASED FROM RESTRICTIONS

Net assets released from restrictions included the following for the years ended June 30, 2011 and 2010:

	2011	2010
Endowment earnings appropriated for expenditure	\$ 729,120	\$ 762,186
Contributions whose purpose restrictions have been satisfied	188,163	82,590
Contributions whose time restrictions have been satisfied	<u>1,173,182</u>	<u>1,179,582</u>
Total net asset released from restrictions	<u>\$ 2,090,465</u>	<u>\$ 2,024,358</u>

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 9 – RETIREMENT BENEFIT PLAN

All employees that work at least 1,000 hours during the year and meet certain age and length of service requirements are eligible to participate in the Allied Arts 401(k) plan. Allied Arts contributes 6% of covered compensation to the plan. An employee may contribute up to 15% of compensation subject to the plan maximum. Employer and employee contributions are vested immediately. Total retirement benefit plan expenses incurred during the years ended June 30, 2011 and 2010 were \$18,348 and \$17,354, respectively.

NOTE 10 – OPERATING LEASES

Allied Arts leases property and equipment under various lease agreements. Rent expense for the years ended June 30, 2011 and 2010 totaled \$35,997 and \$34,893, respectively. All leases except the property lease are renegotiated on an annual basis.

In May 2011, the Organization accepted a one-year renewal option of their lease contract, which extends the agreement through July 2012. Future minimum rental payments for the current lease are as follows:

June 30, 2012	\$42,180
June 30, 2013	3,515

NOTE 11 – AGENCY ALLOCATIONS AND GRANTS

Member agency allocations approved by the Board of Directors for 2011 and 2010 are as follows:

	2011	2010
Board approved allocations:		
Arts & Education Council	\$ 45,496	\$ 45,496
Association for Visual Artists	52,000	49,368
Ballet Tennessee	43,560	43,560
Chattanooga African American Museum	41,140	41,140
Chattanooga Ballet	52,224	52,224
Chattanooga Boys Choir	37,752	37,752
Chattanooga Girls Choir	25,168	25,168
Chattanooga Regional History Museum	40,000	49,000
Chattanooga Symphony and Opera Association	474,320	474,320
Chattanooga Theatre Centre	157,300	157,300
Choral Arts Society	7,260	7,260
Creative Discovery Museum	120,000	114,224
Houston Museum	-	34,364
Hunter Museum of Art	353,804	353,804

(Continued)

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 11 – AGENCY ALLOCATIONS AND GRANTS (Continued)

Shaking Ray Levi Society	<u>7,744</u>	<u>7,744</u>
Agency allocations and grants	1,457,768	1,492,724
Investment income distributed to member agencies from earnings on permanently restricted net assets which are not included in the allocations above	<u>239,541</u>	<u>252,186</u>
Total allocation	<u>\$ 1,697,309</u>	<u>\$ 1,744,910</u>

Allocation payments and other grant support provided during the years ended June 30, 2011 and 2010 differed from the originally approved Board allocations as follows:

Allocation originally approved by the Board of Directors to funded agencies	\$ 1,744,910	\$ 1,744,910
Approved grants:		
Arts Build Communities project grants	23,001	23,001
Pops on the River	79,159	5,000
Cultural Plan	81,077	-
Arts Leadership Institute	4,031	5,993
Downtown Chattanooga Events	15,126	-
Hamilton County Fair	2,500	2,500
Wolfbrown Market Research	50,000	50,000
American Recovery and Reinvestment Act Distributions	-	94,000
Other special projects	<u>8,611</u>	<u>2,262</u>
	<u>\$ 2,008,415</u>	<u>\$ 1,927,666</u>

NOTE 12 – UNCERTAIN TAX POSITIONS

The Organization follows the guidance of ASC Topic 740, *Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. This interpretation prescribed a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, ASC Topic 740 provides guidance on derecognition, classification, interest and penalties, disclosure and transition. The Organization adopted the provisions of ASC Topic 740 and they had no impact on the financial position, results of operations, and cash flows.

Based on its evaluation, the Organization has concluded that there are no significant uncertain tax positions requiring recognition in its financial statements. The Organization's evaluation was performed for tax years ended June 30, 2009 through June 30, 2011 for federal income tax, the years that remain subject to examination by major tax jurisdictions as of June 30, 2011.

ALLIED ARTS OF GREATER CHATTANOOGA

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 13 – RELATED PARTY TRANSACTIONS

During the years ended June 30, 2011 and 2010, the Organization had \$3,423 and \$7,248 of purchases from Maycreate Idea Group, LLC. The organization has a serving board member who holds ownership interest in Maycreate Idea Group, LLC. The Organization had no accounts payable due to a related party as of June 30, 2011. As of June 30, 2010 the Organization had \$701 of accounts payable to Maycreate Idea Group, LLC. There were no other related party transactions for the years ended June 30, 2011 and 2010.

NOTE 14 – SUBSEQUENT EVENTS

Management has evaluated events and transactions subsequent to the balance sheet date through the date of the auditor's report (the date the financial statements were available to be issued) for potential recognition or disclosure in the financial statements. Management has not identified any items requiring recognition or disclosure.

SUPPLEMENTAL SCHEDULES

ALLIED ARTS OF GREATER CHATTANOOGA

SCHEDULES OF SELECTED OPERATING ACTIVITIES

YEAR ENDED JUNE 30, 2011

	Budget	Actual
Salaries and payroll taxes	\$ 329,405	\$ 331,560 *
Employee benefits	40,147	40,818
Telephone	5,800	5,863
Postage	5,200	928
Supplies and printing	6,650	7,585
Rent, security, maintenance and utilities	54,027	54,348
Dues	4,200	3,725
Conference and training	5,000	1,690
Travel and entertainment	2,250	2,468
Professional fees	15,500	14,095
Member services and miscellaneous	3,500	6,495 **
Board functions/donor relations	2,000	2,546
Insurance	5,841	5,529
	<u>\$ 479,520</u>	<u>\$ 477,650</u>
*Program services		\$ 116,046
Management and general		135,940
Fundraising		<u>79,574</u>
		<u>\$ 331,560</u>

**Miscellaneous expenses include non-cash transaction (e.g., in-kind gift expenses) and bank charges netted against budgeted income withdrawals.

***Budget is based on cash basis; therefore, depreciation expense is not a budgeted item.

ALLIED ARTS OF GREATER CHATTANOOGA

SCHEDULES OF SELECTED OPERATING ACTIVITIES

YEAR ENDED JUNE 30, 2010

	Budget	Actual
Salaries and payroll taxes	\$ 311,168	\$ 313,504 *
Employee benefits	39,113	39,235
Telephone	5,680	5,771
Postage	5,460	1,485
Supplies and printing	7,500	6,091
Rent, security, maintenance and utilities	56,439	49,622
Dues	3,043	4,171
Conference and training	-	3,718
Travel and entertainment	2,000	2,243
Professional fees	14,600	13,935
Member services and miscellaneous	4,000	5,211 **
Board functions/donor relations	2,000	2,010
Insurance	5,391	5,314
	<u>\$ 456,394</u>	<u>\$ 452,310</u>
*Program services		\$ 109,726
Management and general		128,537
Fundraising		<u>75,241</u>
		<u>\$ 313,504</u>

**Miscellaneous expenses include non-cash transaction (e.g., in-kind gift expenses) and bank charges netted against budgeted income withdrawals.

***Budget is based on cash basis; therefore, depreciation expense is not a budgeted item.