

MEXICAN HERITAGE CORPORATION
AUDITED FINANCIAL STATEMENTS
JUNE 30, 2004 AND 2003

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Mexican Heritage Corporation
San Jose, California

We have audited the accompanying statements of financial position of the Mexican Heritage Corporation (the Corporation) as of June 30, 2004 and 2003 and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the Corporation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with U.S. generally accepted auditing standards. 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 the Corporation as of June 30, 2004 and 2003 and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note H to the financial statements, the Corporation's total liabilities exceeded its total assets causing a net deficiency in net assets that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note H. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Petrinovich Pugh & Company, LLP

San Jose, California
November 4, 2004

MEXICAN HERITAGE CORPORATION
STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2004 AND 2003

<u>ASSETS</u>	<u>2004</u>	<u>2003</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 39,109	\$ 115,995
Accounts receivable, net of allowance for doubtful accounts of \$88,650 in 2004 and \$5,500 in 2003	86,145	44,040
Grants receivable	48,595	27,921
Prepaid expenses	49,912	24,582
Total current assets	<u>223,761</u>	<u>212,538</u>
PROPERTY AND EQUIPMENT:		
Furniture and equipment	353,530	247,743
Leasehold improvements	64,208	64,208
	<u>417,738</u>	<u>311,951</u>
Less accumulated depreciation and amortization	(204,939)	(174,965)
Net property and equipment	<u>212,799</u>	<u>136,986</u>
	<u>\$ 436,560</u>	<u>\$ 349,524</u>
 <u>LIABILITIES AND NET ASSET DEFICIENCY</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 115,010	\$ 91,285
Accrued expenses	82,514	28,312
Deposits	21,880	24,962
Deferred revenue	103,624	128,337
Current portion of note payable	50,000	50,000
Total current liabilities	<u>373,028</u>	<u>322,896</u>
NOTE PAYABLE, less current portion	600,000	600,000
NET ASSET DEFICIENCY:		
Unrestricted	(603,611)	(573,372)
Temporarily restricted	67,143	-
Total net asset deficiency	<u>(536,468)</u>	<u>(573,372)</u>
	<u>\$ 436,560</u>	<u>\$ 349,524</u>

See accompanying independent auditors' report and notes to financial statements.

MEXICAN HERITAGE CORPORATION
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	
			<u>2004</u>	<u>2003</u>
REVENUES:				
Grants	\$ 637,823	\$ 50,000	\$ 687,823	\$ 658,106
Donated products and services	680,927	-	680,927	818,929
Facility rental	496,151	-	496,151	467,763
Contributions	525,371	40,000	565,371	437,567
Event revenue	136,986	-	136,986	227,749
Heritage arts and education	132,645	-	132,645	127,468
Miscellaneous revenue	5,445	-	5,445	-
Interest	29	-	29	885
Total revenues	<u>2,615,377</u>	<u>90,000</u>	<u>2,705,377</u>	<u>2,738,467</u>
EXPENSES:				
Management and general expenses	413,206	-	413,206	369,029
Program expenses	2,171,491	-	2,171,491	2,255,543
Fundraising expenses	83,776	-	83,776	56,741
Total expenses	<u>2,668,473</u>	<u>-</u>	<u>2,668,473</u>	<u>2,681,313</u>
NET ASSETS RELEASED FROM RESTRICTIONS	<u>22,857</u>	<u>(22,857)</u>	<u>-</u>	<u>-</u>
(Decrease) Increase in unrestricted net assets	(30,239)	67,143	36,904	57,154
Net asset deficiency, beginning of year	<u>(573,372)</u>	<u>-</u>	<u>(573,372)</u>	<u>(630,526)</u>
Net asset deficiency, end of year	<u>\$ (603,611)</u>	<u>\$ 67,143</u>	<u>\$ (536,468)</u>	<u>\$ (573,372)</u>

See accompanying independent auditors' report and notes to financial statements.

MEXICAN HERITAGE CORPORATION

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Decrease) Increase in unrestricted net assets	\$ 36,904	\$ 57,154
Adjustments to reconcile increase in net assets to net cash (used for) provided by operating activities:		
Depreciation and amortization	29,974	25,877
Allowance for doubtful accounts	83,150	-
Contributions of equipment	(48,969)	(21,157)
Changes in certain current assets and liabilities:		
Accounts receivable	(125,255)	49,188
Grants receivable	(20,674)	28,413
Prepaid expenses	(25,330)	17,117
Accounts payable	23,725	(12,730)
Accrued expenses	54,202	(33,156)
Deferred revenue	(24,713)	(72,384)
Net cash (used for) provided by operating activities	(16,986)	38,322
CASH FLOWS FROM INVESTING ACTIVITIES:		
(Decrease) Increase in deposits	(3,082)	2,089
Purchases of furniture and equipment	(56,818)	(1,998)
Net cash used for investing activities	(59,900)	91
Net (decrease) increase in cash and cash equivalents	(76,886)	38,413
Cash and cash equivalents, beginning of year	115,995	77,582
Cash and cash equivalents, end of year	\$ 39,109	\$ 115,995

See accompanying independent auditors' report and notes to financial statements.

MEXICAN HERITAGE CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2004

EXPENSES:	<u>MANAGEMENT AND GENERAL</u>	<u>PROGRAM SERVICES</u>	<u>FUNDRAISING</u>	<u>TOTAL</u>
Salaries and benefits	\$ 323,863	\$ 457,203	\$ 29,842	\$ 810,908
Contractors	33,196	31,104	39,438	103,738
Contract teachers	-	171,855	-	171,855
Contract fees artist	-	115,041	-	115,041
Bad debt expense	-	108,598	-	108,598
Insurance	1,160	36,736	773	38,669
Credit card fees	-	2,955	-	2,955
Legal and accounting fees	21,224	-	-	21,224
Supplies	1,235	39,097	823	41,155
Security	1,724	54,591	1,149	57,464
Utilities	4,150	131,418	2,767	138,335
Telephone	470	14,880	313	15,663
Marketing and advertising	-	148,886	-	148,886
Postage and copy	476	15,069	317	15,862
Subscriptions	990	2,500	-	3,490
Travel and lodging	-	7,741	-	7,741
Catering	1,028	73,269	2,036	76,333
Maintenance and repairs	2,606	82,521	1,737	86,864
Rent	2,660	623,000	2,152	627,812
Gallery	-	-	-	-
Special events	-	277	-	277
Other non-labor	10,008	34,875	746	45,629
Total expenses before depreciation and amortization	404,790	2,151,616	82,093	2,638,499
Depreciation and amortization	8,416	19,875	1,683	29,974
 Total expenses	<u>\$ 413,206</u>	<u>\$ 2,171,491</u>	<u>\$ 83,776</u>	<u>\$ 2,668,473</u>

See accompanying independent auditors' report and notes to financial statements.

MEXICAN HERITAGE CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2003

EXPENSES:	<u>MANAGEMENT AND GENERAL</u>	<u>PROGRAM SERVICES</u>	<u>FUNDRAISING</u>	<u>TOTAL</u>
Salaries and benefits	\$ 325,641	\$ 464,038	\$ 24,423	\$ 814,102
Contractors	2,148	64,200	19,338	85,686
Contract teachers	-	179,129	-	179,129
Contract fees artist	-	96,904	-	96,904
Bad debt expense	-	33,007	-	33,007
Insurance	822	26,042	548	27,412
Credit card fees	510	4,751	-	5,261
Legal and accounting fees	19,231	-	-	19,231
Supplies	947	29,982	631	31,560
Security	2,160	68,396	1,440	71,996
Utilities	4,481	141,907	2,987	149,375
Telephone	569	18,026	379	18,974
Marketing and advertising	-	228,093	-	228,093
Postage and copy	302	9,569	201	10,072
Subscriptions	-	4,246	-	4,246
Travel and lodging	-	24,116	-	24,116
Catering	-	20,599	-	20,599
Maintenance and repairs	3,087	97,751	2,057	102,895
Rent	-	686,736	-	686,736
Gallery	-	6,304	-	6,304
Special events	-	20	-	20
Other non-labor	5,508	30,249	3,961	39,718
Total expenses before depreciation and amortization	365,406	2,234,065	55,965	2,655,436
Depreciation and amortization	3,623	21,478	776	25,877
 Total expenses	 <u>\$ 369,029</u>	 <u>\$ 2,255,543</u>	 <u>\$ 56,741</u>	 <u>\$ 2,681,313</u>

See accompanying independent auditors' report and notes to financial statements.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE A – SIGNIFICANT ACCOUNTING POLICIES

Organization – The Mexican Heritage Corporation of San Jose, California (the Corporation) exists to affirm, celebrate and preserve the rich cultural heritage of San Jose, by promoting the arts, building community, and advancing social and economic development.

The Corporation operates and manages the Mexican Heritage Plaza (the Facilities) to fulfill the following objectives:

- To provide the highest quality of artistic and cultural programming to visitors and residents of the City of San Jose.
- To make the Facilities available to the public.
- To develop and maintain a capable, experienced, professional staff to operate the Facilities in a first-class-manner.
- To provide outreach to public schools.

Basis of Presentation – The financial statements are prepared using the accrual basis of accounting and in accordance with Statements of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not-for-Profit Organizations. Accordingly, the classification of the Corporation's net assets and its revenues and expenditures is based on the existence or absence of donor-imposed restrictions. The provisions of this standard require amounts of each of three classes of net assets, permanently restricted, temporarily restricted, and unrestricted, be displayed in the statement of financial position and the change in each of those classes of net assets be presented in the statement of activities. Unrestricted net assets represent the portion of expendable funds that are available for support of the Corporation's operations.

Cash Equivalents – For purposes of the statements of financial position and cash flows, the Corporation considers all highly liquid debt instruments with insignificant interest rate risk and with maturities of ninety days or less to be cash equivalents.

Accounts Receivable – The Corporation uses the allowance method of accounting for losses arising from uncollectible accounts receivable. Under this method, accounts receivable are written off to allowance for doubtful accounts in the period they are deemed to be uncollectible. An allowance for doubtful accounts is computed based upon historical data and management estimates of uncollectible accounts.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE A – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment – Property and equipment are stated at cost and depreciated over the estimated useful life between three and thirty nine years using the straight-line method. Major repairs or replacements of property and equipment are capitalized. Maintenance, repairs and minor replacements are charged to expense as incurred.

Concentration of Revenue – For the years ended June 30, 2004 and 2003, approximately 23% and 22%, respectively, of the total revenue for the Corporation was funded by grants from the City of San Jose.

Advertising – The Corporation follows the policy of charging the costs of advertising to expense as incurred. Advertising expense was \$148,886 and \$228,093 for the years ended June 30, 2004 and 2003, respectively.

Income Taxes – The Corporation is exempt from income taxes under Internal Revenue Code Section 501(c) (3) and State of California Revenue and Taxation Code 23701(d). Therefore, no income taxes have been provided for in the financial statements.

Impairment of Long-Lived Assets – The Corporation adopted Financial Accounting Standards Board Statement 144 “Accounting for the impairment or Disposal of Long-Lived Assets” (FAS 144) during the fiscal year ended June 30, 2004. Under FAS 144, the Club reviews long-lived assets for impairment when circumstances indicate that the carrying amount of an asset may not be recoverable based upon undiscounted future cash flows of an asset. If the carrying amount of an asset is determined not to be recoverable, a writedown to fair value is recorded. The effects of adopting FAS 144 were not material to the operations of the Corporation.

Use of Estimates – 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Financial Statement Presentation – The financial statements for the year ended June 30, 2003 have been reclassified to conform to the June 30, 2004 presentation.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE B – COMMITMENTS

The Corporation leases its facilities from the City of San Jose under a noncancelable operating lease agreement that expires in the year ending June 30, 2014. The annual rent of \$1 shall be paid on the first business day of each January occurring during the term.

NOTE C – NOTE PAYABLE

The City of San Jose and the Corporation entered into an agreement where the City loaned \$650,000 at zero percent interest. The loan was made to assist the Corporation in the operation and the development of the Facilities based on a resolution of the Council of the City of San Jose, dated June 27, 2000.

The note payable matures over the next five years as follows:

Year ending June 30:	2005	\$ 50,000
	2006	50,000
	2007	50,000
	2008	50,000
	2009	50,000
	Thereafter	<u>400,000</u>
		650,000
	Less current portion	<u>50,000</u>
		<u>\$ 600,000</u>

NOTE D – DONATED PRODUCTS AND SERVICES

Contributions are recognized in accordance with the provisions of SFAS No. 116. Donated equipment and donated goods are recorded at their estimated fair market value as of the date of the donation. Contributed services, which require specialized skills and which the Corporation would have paid for if they had not been donated, are recorded at the estimated fair market value at the time the services are rendered.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE D – DONATED PRODUCTS AND SERVICES (Continued)

For the fiscal years ending June 30, 2004 and 2003 the Corporation received the following in-kind contributions for products and services that meet the above criteria. These amounts have been recognized in the financial statements of the Corporation.

<u>Sponsor Name</u>	<u>2004</u>	<u>2003</u>
City of San Jose (facility lease)	\$ 581,666	\$ 630,139
Hewlett-Packard Company (equipment)	48,969	-
KBRG Radio Romantica	18,450	-
Penny Saver	15,112	-
El Observador Publication	5,280	19,980
Safeway	5,000	-
Arnoldo Mercado	4,630	-
KAZA - Radio	1,600	47,700
Sims & Layton	220	2,063
KSTV - TV	-	37,200
Mervyn's / Target	-	35,889
KSOL - Radio	-	21,500
IBM (equipment)	-	21,157
Casa Adobe	-	1,816
El Mensajero	-	1,485
	<u>\$ 680,927</u>	<u>\$ 818,929</u>

The Corporation also receives donated services that do not require specific expertise, but which are nonetheless central to the Corporation's operations. These contributed services are not reflected in the financial statements.

NOTE E – GRANTS RECEIVABLE

Grants receivables consist of the following:

	<u>2004</u>	<u>2003</u>
Community Foundation Silicon Valley	\$ 30,000	\$ -
City of San Jose	18,595	27,921
	<u>\$ 48,595</u>	<u>\$ 27,921</u>

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE E – GRANTS RECEIVABLE (Continued)

As of June 30, 2004, the grant receivable from the Community Foundation Silicon Valley (\$30,000) is to engage the community in the production of murals in the Mayfair neighborhood. The grant receivable from the City of San Jose (\$18,595) is for support of arts and education programs of the Corporation.

The Corporation received a grant from the State of California, Department of Parks and Recreation in the amount of \$1,000,000. These funds are to be used for the acquisition development, preservation or interpretation (capital improvements only), or any combination thereof, of buildings, structures, sites, places, or artifacts, or any combination thereof that preserve and demonstrate culturally significant aspects of California history. The grant will expire December 31, 2007 if the funds are not used for the designated purpose. Due to the funds being conditional in nature and the uncertainty of the ultimate realization, the grant has not been recorded in the corporation's books. The funds available under this grant will be recognized as revenues and expenditures when the underlying conditions are met.

NOTE F – SIGNIFICANT AGREEMENT

In accordance with the "Operation and Maintenance Agreement" entered into with the City of San Jose in March, 1996, the Corporation shall include in its annual budgets a minimum contribution of three percent (3%) of the budget to a cash flow reserve (Reserve) account. Contributions should be made into the Reserve account until it reaches a maximum of twenty-five percent (25%) of the annual operating budget.

The Corporation is not required to make any contributions to the Reserve Account in excess of one Million Dollars (\$1,000,000) for the first 15 years, Two Million Dollars (\$2,000,000) for years 16 through 25, and Three Million Dollars (\$3,000,000) for years 26 through 35. The phase in of the cash flow Reserve requirement is one (1%) for the first two years, two percent (2%) for the second two years and three percent (3%) annually thereafter. The Corporation has not maintained the required reserve funds. The agreement also requires the Corporation to maintain certain levels of insurance and maintain the facilities. The Corporation has complied with these requirements.

The management of the Corporation requested that the City of San Jose waive the reserve requirements for the first two years of the contract. The City of San Jose approved the two year extension of the waiver. If the reserve had been established for fiscal years ended June 30, 2004 and 2003 the amount applicable would be approximately \$270,000 and \$180,000, respectively.

The Reserve shall be maintained in a separate account and the City of San Jose shall be notified within five (5) days when expenditures are made from the Reserve.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004 AND 2003

NOTE G – 401(K) PLAN

Effective July 1, 2000, the Corporation implemented a 401(k) plan (the Plan). Eligible participants may contribute a percentage of compensation, up to a prescribed maximum, subject to the limitations of Internal Revenue Code Section 401(k). Eligible employees are those who are at least 21 years of age and have completed 6 months of service. The Plan provides for the Corporation to make matching contributions at the discretion of the Board of Directors. The Corporation made no contributions for the years ended June 30, 2004 and 2003.

NOTE H – GOING CONCERN

The Corporation's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

As shown in the accompanying financial statements, as of June 30, 2004 and 2003, the Corporation's total liabilities exceeded its total assets by \$603,611 and \$573,372, respectively. These conditions create an uncertainty as to the Corporation's ability to continue as a going concern. Management of the Corporation has taken certain steps intended to reduce operating expenses and increase support revenue to restore profitability. The ability of the Corporation to continue as a going concern is dependent upon the success of these actions. The financial statements do not include any adjustment relating to the recoverability of recorded asset amounts or the amounts of liabilities that might be necessary should the Corporation be unable to continue as a going concern.