

MEXICAN HERITAGE CORPORATION
AUDITED FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005

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Contents

	<u>Page</u>
Independent Auditors' Report	1
Statements of Financial Position	2
Statements of Activities and Changes in Net Assets	3
Statements of Cash Flows	4
Statements of Functional Expenses	5-6
Notes to Financial Statements	7-12



PETRINOVICH PUGH & COMPANY, LLP
Certified Public Accountants & Consultants

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, 2006 and 2005 and the related statements of activities and changes in net assets, cash flows and functional expenses 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 audits.

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 positions of the Corporation as of June 30, 2006 and 2005 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 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
May 30, 2007

MEXICAN HERITAGE CORPORATION
STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2006 AND 2005

ASSETS	<u>2006</u>	<u>2005</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 243,628	\$ 5,202
Accounts receivable	20,796	70,466
Prepaid expenses	5,014	87,164
Total current assets	<u>269,438</u>	<u>162,832</u>
PROPERTY AND EQUIPMENT:		
Furniture and equipment	401,095	353,530
Leasehold improvements	64,208	64,208
	<u>465,303</u>	<u>417,738</u>
Less accumulated depreciation and amortization	<u>(324,437)</u>	<u>(257,334)</u>
Net property and equipment	<u>140,866</u>	<u>160,404</u>
	<u><u>\$ 410,304</u></u>	<u><u>\$ 323,236</u></u>
 LIABILITIES AND NET ASSET DEFICIENCY		
CURRENT LIABILITIES:		
Accounts payable	\$ 289,871	\$ 258,226
Accrued expenses	46,941	43,071
Deposits	25,185	21,728
Deferred revenue	112,239	72,935
Current portion of note payable	50,000	50,000
Total current liabilities	<u>524,236</u>	<u>445,960</u>
NOTE PAYABLE, less current portion	500,000	550,000
NET ASSET DEFICIENCY:		
Unrestricted	(613,932)	(692,724)
Temporarily restricted	-	20,000
Total net asset deficiency	<u>(613,932)</u>	<u>(672,724)</u>
	<u><u>\$ 410,304</u></u>	<u><u>\$ 323,236</u></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, 2006 AND 2005

	Unrestricted	Temporarily Restricted	Total	
			2006	2005
REVENUES:				
Grants	\$ 457,767	\$ 181,305	\$ 639,072	\$ 554,546
Donated products and services	1,861,714	-	1,861,714	1,359,083
Facility rental	320,477	-	320,477	359,500
Contributions	502,477	-	502,477	237,384
Event revenue	282,548	-	282,548	139,821
Heritage arts and education	38,171	-	38,171	85,662
Miscellaneous revenue	24,949	-	24,949	18,521
Interest	144	-	144	65
Total revenues	<u>3,488,247</u>	<u>181,305</u>	<u>3,669,552</u>	<u>2,754,582</u>
EXPENSES:				
Management and general expenses	1,106,787	-	1,106,787	1,061,890
Program expenses	2,363,476	-	2,363,476	1,685,280
Fundraising expenses	140,497	-	140,497	143,668
Total expenses	<u>3,610,760</u>	<u>-</u>	<u>3,610,760</u>	<u>2,890,838</u>
Net assets released from restrictions	<u>201,305</u>	<u>(201,305)</u>	<u>-</u>	<u>-</u>
Increase (decrease) in net assets	78,792	(20,000)	58,792	(136,256)
Net asset deficiency, beginning of year	<u>(692,724)</u>	<u>20,000</u>	<u>(672,724)</u>	<u>(536,468)</u>
Net asset deficiency, end of year	<u>\$ (613,932)</u>	<u>\$ -</u>	<u>\$ (613,932)</u>	<u>\$ (672,724)</u>

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

MEXICAN HERITAGE CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase (decrease) in net assets	\$ 58,792	\$ (136,256)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	67,103	52,395
Allowance for doubtful accounts	-	(88,650)
Changes in certain current assets and liabilities:		
Accounts receivable	49,670	104,329
Prepaid expenses	82,150	(37,252)
Grants receivable	-	48,595
Accounts payable	31,645	143,216
Accrued expenses	3,870	(39,443)
Deferred revenue	39,304	(30,689)
Net cash provided by operating activities	332,534	16,245
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase (decrease) in deposits	3,457	(152)
Purchases of furniture and equipment	(47,565)	-
Net cash used for investing activities	(44,108)	(152)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on note payable	(50,000)	(50,000)
Net cash used for financing activities	(50,000)	(50,000)
Net increase (decrease) in cash and cash equivalents	238,426	(33,907)
Cash and cash equivalents, beginning of year	5,202	39,109
Cash and cash equivalents, end of year	\$ 243,628	\$ 5,202

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

MEXICAN HERITAGE CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2006

	<u>Management and General</u>	<u>Program Services</u>	<u>Fundraising</u>	<u>Total</u>
Bank fees	\$ 446	\$ -	\$ -	\$ 446
Catering	595	20,047	-	20,642
Contract fees artist	62,553	171,262	49,320	283,135
Contract teachers	-	18,850	-	18,850
Contractors	6,327	-	8,960	15,287
Gallery	-	38,799	-	38,799
Insurance	37,050	-	-	37,050
Legal and accounting fees	92,913	-	290	93,203
Maintenance and repairs	67,861	2,435	-	70,296
Marketing and advertising	43,499	1,016,221	-	1,059,720
Other non-labor	3,450	-	-	3,450
Postage and copy	6,832	40,190	56	47,078
Rent	168,667	801,030	37,940	1,007,637
Salaries and benefits	369,582	150,427	37,843	557,852
Security	13,281	14,608	424	28,313
Special events	-	21,914	-	21,914
Subscriptions	12,024	300	-	12,324
Supplies	9,252	5,068	60	14,380
Telephone	9,640	5,405	1,810	16,855
Travel and lodging	13,874	11,365	30	25,269
Utilities	170,098	1,059	-	171,157
Total expenses before depreciation and amortization	<u>1,087,944</u>	<u>2,318,980</u>	<u>136,733</u>	<u>3,543,657</u>
Depreciation and amortization	<u>18,843</u>	<u>44,496</u>	<u>3,764</u>	<u>67,103</u>
Total expenses	<u>\$ 1,106,787</u>	<u>\$ 2,363,476</u>	<u>\$ 140,497</u>	<u>\$ 3,610,760</u>

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

MEXICAN HERITAGE CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2005

	<u>Management and General</u>	<u>Program Services</u>	<u>Fundraising</u>	<u>Total</u>
Bank fees	\$ 4,126	\$ -	\$ 2,166	\$ 6,292
Catering	17,225	315	26,190	43,730
Contract fees artist	6,150	67,543	15,950	89,643
Contract teachers	950	108,455	-	109,405
Contractors	37,197	32,446	1,620	71,263
Gallery	-	863	-	863
Insurance	25,467	-	-	25,467
Legal and accounting fees	19,290	302	-	19,592
Maintenance and repairs	49,842	1,998	250	52,090
Marketing and advertising	6,552	526,995	20,525	554,072
Other non-labor	10,577	17,915	-	28,492
Postage and copy	3,755	4,779	5,024	13,558
Rent	152,519	756,847	32,689	942,055
Salaries and benefits	514,993	92,186	32,438	639,617
Security	35,373	12,806	262	48,441
Special events	-	5,671	195	5,866
Subscriptions	1,089	-	175	1,264
Supplies	18,543	3,261	519	22,323
Telephone	16,915	4,536	1,496	22,947
Travel and lodging	4,232	13,010	1,235	18,477
Utilities	122,372	614	-	122,986
Total expenses before depreciation and amortization	1,047,167	1,650,542	140,734	2,838,443
Depreciation and amortization	14,723	34,738	2,934	52,395
Total expenses	<u>\$ 1,061,890</u>	<u>\$ 1,685,280</u>	<u>\$ 143,668</u>	<u>\$ 2,890,838</u>

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

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

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 statements of financial position and the change in each of those classes of net assets be presented in the statements of activities and changes in net assets. Unrestricted net assets represent the portion of expendable funds that are available for support of the Corporation's operations.

Cash and 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. As of June 30, 2006 and 2005, the allowance for doubtful accounts was zero.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

NOTE A – SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and equipment – Property and equipment are stated at cost. Depreciation is computed using accelerated methods over lives ranging from three to 39 years. 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, 2006 and 2005, approximately 39% and 39%, respectively, of the total revenue for the Corporation was funded by grants from the City of San Jose.

Concentration of credit risk - The Corporation maintains cash deposits in excess of the FDIC insured amount of \$100,000 with a financial institution. As of June 30, 2006, the Corporation had approximately \$75,000 in deposits in excess of the federally insured limit. Risk associated with cash is mitigated by maintaining deposits with a credit worthy institution.

Advertising – The Corporation expenses advertising costs as incurred. Advertising expense was \$197,883 and \$83,646 for the years ended June 30, 2006 and 2005, 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 accounts for impairment of assets under *Financial Accounting Standards Board Statement 144, Accounting for the Impairment or Disposal of Long-Lived Assets (FAS 144)*, which requires the Corporation to review 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 not to be recoverable, a writedown to fair value is recorded. During the years ended June 30, 2006 and 2005, there were no impairment expenses recorded.

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.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

NOTE B – COMMITMENTS

The Corporation leases its facilities from the City of San Jose under a noncancelable operating lease agreement that expires during 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.

The Corporation also leases certain equipment under an operating lease agreement which amounts to \$1,822 and expires December 2006.

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:	2007	\$ 50,000
	2008	50,000
	2009	50,000
	2010	50,000
	2011	50,000
	Thereafter	<u>300,000</u>
		550,000
	Less current portion	<u>50,000</u>
		<u>\$ 500,000</u>

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

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 had to pay for if they had not been donated, are recorded at the estimated fair market value at the time the services are rendered.

For the fiscal years ended June 30, 2006 and 2005, 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>2006</u>	<u>2005</u>
City of San Jose (facility lease)	\$ 955,006	\$ 888,657
KPIX Ch 5/UPN	136,000	-
Univision / Telefutera	130,000	55,000
Mercury News / Nuevo Mundo	88,478	61,098
KISS-FM	85,000	-
Wild 94.9	74,500	73,450
KBRG Radio Romantica	70,000	22,000
El Mensajero	37,400	7,024
La Preciosa 92.3 FM	37,000	-
Telemundo / NBC-11	35,000	23,000
El Observador Publication	30,000	8,170
La Raza KRZZ 93.3	29,500	-
Cumbia 1170AM	26,730	14,400
Azteca America	22,000	32,500
Univision Radio / Estereo Sol	21,850	12,500
La Oferta	15,750	5,670
KAZA - Radio	15,000	10,000
Alianza	15,000	6,464
Kaliente	15,000	3,450
PennySaver	12,500	-
Safeway	10,000	-
Ad impressions	-	120,000
KLIV 1590 / KRTY 95.3	-	13,700
Enoque	-	2,000
	<u>\$ 1,861,714</u>	<u>\$ 1,359,083</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.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

NOTE E – GRANTS RECEIVABLE

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. During the year ended June 30, 2006, approximately \$181,000 was used for this purpose. The grant will expire December 31, 2007 if the funds available are not used for the designated purpose. Due to the funds being conditional in nature and the uncertainty of the ultimate realization, the remaining funds available of approximately \$819,000 have not been recorded on the Corporation's financial statements. The remaining 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" (the 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 account (the Reserve). 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 in excess of \$1,000,000 for the first 15 years, \$2,000,000 for years 16 through 25, and \$3,000,000 for years 26 through 35. The phase-in of the cash flow reserve requirement is one percent (1%) for the first two years, two percent (2%) for the second two years and three percent (3%) annually thereafter. 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.

The management of the Corporation requested that the City of San Jose waive the Reserve requirements for the first two years of the Agreement. The City of San Jose approved the two year extension of the waiver. The Corporation has not maintained the required Reserve fund. If the Reserve had been established for fiscal years ended June 30, 2006 and 2005, the amount applicable would be approximately \$365,000 and \$317,000, respectively. The City of San Jose is aware that this reserve fund has not been funded.

The Agreement requires the Corporation to maintain certain levels of insurance and maintain the Facility. The Corporation has complied with these requirements.

MEXICAN HERITAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

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. 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 to the Plan for the years ended June 30, 2006 and 2005.

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, 2006 and 2005, the Corporation's total liabilities exceeded its total assets by \$613,932 and \$672,724, 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.