

School of Arts and Culture at MHP

Financial Statements

June 30, 2018
(With Comparative Totals for 2017)



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
School of Arts and Culture at MHP
San Jose, California

We have audited the accompanying financial statements of School of Arts and Culture at MHP (a California non-profit corporation) (the "School"), which comprise the statement of financial position as of June 30, 2018, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (the "U.S."); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of School of Arts and Culture at MHP as of June 30, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the U.S.

Report on Summarized Comparative Information

We have previously audited School of Arts and Culture at MHP's 2017 financial statements, and our report dated January 8, 2018 expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017, is consistent, in all material respects, with the audited financial statements from which it has been derived.

A handwritten signature in black ink that reads "Armanino LLP". The signature is written in a cursive, flowing style.

Armanino^{LLP}
San Jose, California

November 26, 2018

School of Arts and Culture at MHP
Statement of Financial Position
June 30, 2018
(With Comparative Totals for 2017)

	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	\$ 437,609	\$ 426,012
Cash - Agency fund for scholarships	22,445	22,445
Accounts receivable	31,107	53,859
Grants receivable, current portion	443,337	372,083
Pledges receivable	-	300
Donated rent receivable, current portion (Note 5)	540,131	528,388
Prepaid expenses and deposits	28,355	27,616
Total current assets	1,502,984	1,430,703
Property and equipment, net	66,810	71,621
Other assets		
Grants receivable, net of current portion	186,667	-
Donated rent receivable, net of current portion (Note 5)	6,107,533	6,647,658
Total other assets	6,294,200	6,647,658
Total assets	\$ 7,863,994	\$ 8,149,982
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable and accrued liabilities	\$ 193,436	\$ 207,499
Agency fund for scholarships payable	22,445	22,445
Deferred revenue	91,256	123,855
Total current liabilities	307,137	353,799
Net assets		
Unrestricted	346,867	364,591
Temporarily restricted	7,209,990	7,431,592
Total net assets	7,556,857	7,796,183
Total liabilities and net assets	\$ 7,863,994	\$ 8,149,982

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

School of Arts and Culture at MHP
Statement of Activities
For the Year Ended June 30, 2018
(With Comparative Totals for 2017)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>2018 Total</u>	<u>2017 Total</u>
Support and revenue				
Support				
Grants and contributions	\$ 947,304	\$ 911,457	\$ 1,858,761	\$ 1,313,679
Donated rent present value discount amortization (Note 5)	<u>-</u>	<u>152,566</u>	<u>152,566</u>	<u>164,055</u>
Total support	<u>947,304</u>	<u>1,064,023</u>	<u>2,011,327</u>	<u>1,477,734</u>
Revenue				
Rental income	703,090	-	703,090	646,549
Tuition and fees	98,679	-	98,679	99,331
Other revenue	16,883	-	16,883	26,315
Interest income	<u>397</u>	<u>-</u>	<u>397</u>	<u>411</u>
Total revenue	<u>819,049</u>	<u>-</u>	<u>819,049</u>	<u>772,606</u>
Total support and revenue	1,766,353	1,064,023	2,830,376	2,250,340
Net assets released from restriction	<u>1,285,625</u>	<u>(1,285,625)</u>	<u>-</u>	<u>-</u>
Total support and revenue and net assets released from restriction	<u>3,051,978</u>	<u>(221,602)</u>	<u>2,830,376</u>	<u>2,250,340</u>
Expenses				
Program services				
Arts education program	717,598	-	717,598	679,576
Events - community access and engagement and market rental program	855,442	-	855,442	760,201
Multicultural arts leadership institute	104,139	-	104,139	113,876
Facility	679,124	-	679,124	576,340
Mayferia	<u>272,998</u>	<u>-</u>	<u>272,998</u>	<u>199,616</u>
Total program services	<u>2,629,301</u>	<u>-</u>	<u>2,629,301</u>	<u>2,329,609</u>
Support services				
Management and general	310,011	-	310,011	305,002
Fundraising	<u>130,390</u>	<u>-</u>	<u>130,390</u>	<u>135,947</u>
Total support services	<u>440,401</u>	<u>-</u>	<u>440,401</u>	<u>440,949</u>
Total functional expenses	<u>3,069,702</u>	<u>-</u>	<u>3,069,702</u>	<u>2,770,558</u>
Change in net assets (Note 3)	(17,724)	(221,602)	(239,326)	(520,218)
Net assets, beginning of year	<u>364,591</u>	<u>7,431,592</u>	<u>7,796,183</u>	<u>8,316,401</u>
Net assets, end of year	<u>\$ 346,867</u>	<u>\$ 7,209,990</u>	<u>\$ 7,556,857</u>	<u>\$ 7,796,183</u>

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

School of Arts and Culture at MHP
Statement of Functional Expenses
For the Year Ended June 30, 2018
(With Comparative Totals for 2017)

	Program services					Support services				2018 Total	2017 Total
	Arts education program	Events - community access and engagement and market rental program	Multicultural arts leadership institute	Facility	Mavferia	Total program services	Management and general	Fundraising	Total support services		
Personnel expenses											
Salaries and wages	\$ 140,843	\$ 103,538	\$ 42,670	\$ 84,145	\$ 41,346	\$ 412,542	\$ 72,376	\$ 40,879	\$ 113,255	\$ 525,797	\$ 453,555
Employee benefits	19,752	8,032	4,510	7,455	4,814	44,563	5,149	3,048	8,197	52,760	49,108
Payroll taxes	11,914	8,346	3,325	6,311	3,166	33,062	7,896	3,328	11,224	44,286	37,973
Total personnel expenses	172,509	119,916	50,505	97,911	49,326	490,167	85,421	47,255	132,676	622,843	540,636
Outside services	164,040	339,821	4,879	109,974	100,190	718,904	34,534	68,937	103,471	822,375	619,699
Donated rent	283,452	157,658	20,781	207,671	-	669,562	9,038	2,355	11,393	680,955	680,955
Utilities	47,079	55,639	6,413	57,779	17,120	184,030	19,260	10,698	29,958	213,988	194,215
Event rental expense	590	157,150	618	-	30,621	188,979	6,859	-	6,859	195,838	206,003
Repairs and maintenance	-	-	-	173,734	-	173,734	-	-	-	173,734	206,474
Professional fees	10,935	1,843	-	-	10,950	23,728	90,487	-	90,487	114,215	103,063
Supplies, including in-kind	5,100	5,058	8,982	24,651	18,057	61,848	7,895	31	7,926	69,774	48,635
Marketing and recruiting expense	14,965	6,989	123	-	45,378	67,455	353	175	528	67,983	66,774
Travel	2,935	3,421	11,039	-	626	18,021	79	13	92	18,113	19,857
Insurance	-	-	-	-	353	353	15,710	-	15,710	16,063	15,726
Depreciation	6,274	3,490	460	4,596	-	14,820	460	52	512	15,332	15,322
Bank charges	-	-	-	-	-	-	15,114	-	15,114	15,114	18,345
Telephone	4	-	-	-	-	4	11,539	-	11,539	11,543	8,710
Bad debt expense	3,589	2,874	-	-	-	6,463	1,083	-	1,083	7,546	2,495
Conferences, conventions and meetings	90	-	199	-	268	557	6,114	524	6,638	7,195	10,759
Printing and publication	4,446	623	-	-	-	5,069	521	-	521	5,590	2,659
Dues and subscriptions	1,409	374	-	684	109	2,576	2,988	-	2,988	5,564	5,204
Training	-	-	140	-	-	140	1,650	350	2,000	2,140	2,760
Taxes and licenses	-	586	-	885	-	1,471	602	-	602	2,073	1,367
Other operating expenses	-	-	-	1,239	-	1,239	-	-	-	1,239	213
Postage and shipping	181	-	-	-	-	181	304	-	304	485	487
Grants	-	-	-	-	-	-	-	-	-	-	200
	<u>\$ 717,598</u>	<u>\$ 855,442</u>	<u>\$ 104,139</u>	<u>\$ 679,124</u>	<u>\$ 272,998</u>	<u>\$ 2,629,301</u>	<u>\$ 310,011</u>	<u>\$ 130,390</u>	<u>\$ 440,401</u>	<u>\$ 3,069,702</u>	<u>\$ 2,770,558</u>
Percentage of total	<u>23 %</u>	<u>28 %</u>	<u>3 %</u>	<u>22 %</u>	<u>9 %</u>	<u>85 %</u>	<u>10 %</u>	<u>5 %</u>	<u>15 %</u>	<u>100 %</u>	

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

School of Arts and Culture at MHP
Statement of Cash Flows
For the Year Ended June 30, 2018
(With Comparative Totals for 2017)

	2018	2017
Cash flows from operating activities		
Change in net assets	\$ (239,326)	\$ (520,218)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation expense	15,332	15,322
Donated rent expense	680,955	680,955
Donated rent present value discount amortization	(152,566)	(164,055)
Changes in operating assets and liabilities		
Accounts receivable	22,752	(40,144)
Grants receivable	(71,254)	45,017
Pledges receivable	300	-
Prepaid expenses and deposits	(739)	(2,012)
Accounts payable and accrued liabilities	(14,063)	(9,484)
Agency fund for scholarships payable	-	850
Deferred revenue	(32,599)	3,833
Net cash provided by operating activities	208,792	10,064
Cash flows from investing activities		
Purchase of property and equipment	(10,528)	(14,699)
Net cash used in investing activities	(10,528)	(14,699)
Net increase (decrease) in cash, cash equivalents and Agency fund	198,264	(4,635)
Cash, cash equivalents and Agency fund, beginning of year	448,457	453,092
Cash, cash equivalents and Agency fund, end of year	\$ 646,721	\$ 448,457
Cash, cash equivalents and Agency fund consisted of the following:		
Cash and cash equivalents	\$ 437,609	\$ 426,012
Cash - Agency fund for scholarships	22,445	22,445
	\$ 460,054	\$ 448,457

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

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

1. NATURE OF OPERATIONS

Guided by a twenty-month community planning process designed to re-imagine Mexican Heritage Plaza's future, a new vision for a School of Arts and Culture at MHP (the "School") was created, embraced by the community and adopted by the City of San Jose in Spring 2011. The School was formally launched in July 2011 with a vision to create a vibrant place of learning, culture and community that nurtures the soul and brings joy, skill building and a sense of belonging to children, families and all who participate. The goal of the School is to narrow the opportunity gap in arts education and learning, nurture the joy, creativity and well-being of our children and unleash the talent of our next generation of students, leaders, artists and consumers of culture. The School is leveraging a \$35 million cultural facility by providing unique and culturally relevant educational offerings of value to the children and families in our community while also creating a "community container" for arts programming with a network of multicultural arts partners. In January 2014, the School was named as the permanent operator of the Mexican Heritage Plaza, and entered into a long-term agreement with the City of San Jose to operate the facility (see Notes 5 and 7).

2. PROGRAM SERVICES

Arts Education Program

The School provides a "multi-cultural and inter-cultural venue" for community events and programs that embrace all cultures, while exploring the artistic traditions, cultural history, and contemporary creative expression of Mexican and Latin American arts. The School believes that the arts are powerful vehicles for human development and social transformation - by creating nurturing communities for children, especially those at risk. The School believes, as research indicates, that creative experiences in the arts offer students the opportunity to "envision and set goals, determine a method to reach a goal, and try it out, identify alternatives, evaluate, revise, solve problems, imagine, work collaboratively, and apply self-discipline" (The California State Board of Education – Visual and Performing Arts).

The goals for the Arts Education Program are to engage youth, ages 4 to 18, in positive, culturally relevant, safe and empowering learning experiences that will inspire and strengthen the youth and families of San Jose to be agents of positive change. To reach these goals, the School seeks to achieve the following objectives: 1) Offer East San Jose students access to arts education; 2) Activate a community asset – the Mexican Heritage Plaza, where the School is located; and 3) Offer quality student learning experiences in the arts. The Arts Education Program provides arts and culture experiences for students ages 0-18, helping them to achieve developmental and educational milestones through quarterly classes in dance and music, rooted in Mexican and Mexican American culture. In 2017, the School adopted a developmental pathway approach in music to offer students sequential instruction that develops solid foundational skills, instrumental technique, music notation, and overall musicianship.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

2. PROGRAM SERVICES (continued)

Events - Community Access and Engagement

The Community Engagement Program provides local artists and arts and community agencies access to the Mexican Heritage Plaza; training and technical assistance on the use of the space; and access to audience networks. Activating and curating the six-acre, \$35M, city-owned facility as a programmable arts and cultural destination and community hub, the School provides East San Jose with a safe, active, family venue for diverse arts activities that speak to its unique cultural heritage.

The School's Community Access policy is defined primarily by the spirit of the Guiding Principles for Community Access and Engagement:

- Create welcoming, inclusive and affordable community gatherings and cultural offerings in partnership with artists, arts organizations and community focused nonprofits that capitalize on the strengths of this unique facility and location in the Eastside of San Jose.
- Develop partnerships with a network of artists, arts and community organizations that will leverage existing relationships and capacity while advancing and growing collective impact.
- Build community confidence, enthusiasm and trust over time through consistent communication, responsiveness and a reliable menu of opportunities.
- Develop a broad mix in programming with a focus on Mexican culture while activating opportunities for social integration with the broader multicultural artistic community present in San Jose.
- Facilitate multiple points of entry for community members, partner organizations as well as private clients.
- Create a relationship of reciprocity with organizations and the community through "mission compatible" activation of spaces.
- Embrace grassroots participation as critical to the success of School of Arts and Culture at MHP's vision, and provide opportunities for community feedback.

Events - Market Rental Program

School of Arts and Culture at MHP is located in a beautiful multi-use venue in a historically significant location and neighborhood. The site is the same place where civil rights activist Cesar Chavez organized the first grape boycott with the farmworker movement. The house he lived in is located a quarter of a mile away from the School.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

2. PROGRAM SERVICES (continued)

Events - Market Rental Program (continued)

The business plan written by the MHP Steering Committee in 2011 identifies rental income from the facility as an important component of the long-term sustainability of School of Arts and Culture at MHP. The School has partnered with a for profit company, Giant Creative Services, to ensure a careful, creative and attentive approach to market rate rentals. This close partnership with the School staff has successfully increased the usage of the facility by a number of arts organizations and private events in a manner never before seen under previous operators. The School's Market Rental Program generates revenue that then directly supports the school program.

Multicultural Arts Leadership Institute (MALI)

The Multicultural Arts Leadership Institute (MALI) is a professional development opportunity for leaders of color in the arts, culture and entertainment sectors. Currently, so many people of color serve their community through the arts but often work in isolation and without much support. The MALI program was created by people of color, with people of color distinctly in mind. It was piloted under the auspices of 1stACT Silicon Valley from 2008 to 2011 and formally became a stand-alone program operated by School of Arts and Culture at MHP in July 2011. The mission of MALI aligns directly with the School of Arts and Culture at MHP's intention to strengthen the multicultural arts community and cultivate new audiences and cross-cultural experiences.

MALI's presence at School of Arts and Culture at MHP provides a network of 110 graduates who are strong multicultural leaders who can be leveraged to advance the vision of the School. The School provides a home for MALI.

Facility

The School operates the Mexican Heritage Plaza, which is owned by the City of San Jose. The School leverages the \$35 million facility to offer its programs, including quality arts education courses to the community through its Arts Education Program; an arts leadership program for people of color (i.e. the Multicultural Arts Leadership Institute); and community events through its Community Access and Engagement and Market Rental programs. In this way, the long underutilized facility is activated and transformed into a vibrant hub of community activity.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

2. PROGRAM SERVICES (continued)

Mayferia

During the year ended June 30, 2017, the School of Arts and Culture at MHP launched a special project initiative called Mayferia. This project celebrates the talent, history, and beauty of the Mayfair community. The School will continue to leverage its connections and role in the community as an anchor agency and convener to recruit community members to participate in the process of initiating, developing, planning and implementing the elements of the project. Mayferia activities bring these rich, multi-faceted cultural activities to an area characterized by gang violence, poverty, blight, a lack of resources. Also, with a predominantly Latino population, Mayferia helps residents to develop and enhance a sense of belonging and pride in their heritage and neighborhood, gaining a broader perspective of the challenges faced by the Mayfair neighborhood and a new perspective on the possibilities for change. Current funding for Mayferia will take the project through the year ending June 30, 2019.

3. CHANGE IN NET ASSETS

During the years ended June 30, 2018 and 2017, the School experienced a decrease in net assets of \$239,326 and \$520,218, respectively. A significant amount of the decrease can be attributed to "Donated rent" expense.

Changes in net assets for the fiscal year ended June 30, 2018 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Change in net assets	\$ (17,724)	\$ (221,602)	\$ (239,326)
Add back:			
Donated rent expense	680,955	-	680,955
Less:			
Release from time restriction (Note 8)	(680,955)	680,955	-
Donated rent present value discount amortization	<u>-</u>	<u>(152,566)</u>	<u>(152,566)</u>
Change in net assets, excluding donated rent expense	<u>\$ (17,724)</u>	<u>\$ 306,787</u>	<u>\$ 289,063</u>

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

3. CHANGE IN NET ASSETS (continued)

Changes in net assets for the fiscal year ended June 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Change in net assets	\$ 311,903	\$ (832,121)	\$ (520,218)
Add back:			
Donated rent expense	680,955	-	680,955
Less:			
Release from time restriction (Note 8)	(680,955)	680,955	-
Donated rent present value discount amortization	<u>-</u>	<u>(164,055)</u>	<u>(164,055)</u>
Change in net assets, excluding donated rent expense	<u>\$ 311,903</u>	<u>\$ (315,221)</u>	<u>\$ (3,318)</u>

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting and financial statement presentation

The financial statements of the School have been prepared on the accrual basis of accounting.

In accordance with accounting principles generally accepted in the United States of America ("GAAP"), the School is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

- *Unrestricted net assets* - include those assets over which the Board of Directors has discretionary control in carrying out the operations of the School. Under this category, the School maintains an operating fund, property and equipment fund plus any net assets designated by the Board for specific purposes.
- *Temporarily restricted net assets* - include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.
- *Permanently restricted net assets* - include those assets which are subject to a non-expiring donor restriction, such as endowments. There are currently no permanently restricted net assets.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Summarized financial information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class or functional expense categories. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the School's audited financial statements for the year ended June 30, 2017, from which the summarized information was derived.

Cash and cash equivalents

Cash and cash equivalents include highly-liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. The School maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The School has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Fair value measurements

Fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

A hierarchy has been established to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). Observable inputs are those that market participants would use in pricing the asset based on market data obtained from sources independent of the School. Unobservable inputs reflect the School's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

- *Level 1* - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.
- *Level 2* - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurements (continued)

- *Level 3* - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the School's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Accounts, grants and pledges receivable

The School considers all accounts, grants and pledges receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary.

Promises to give

Unconditional promises to give, less an allowance for uncollectible amounts, are recognized as support in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Promises are recorded at net realizable value if expected to be collected in one year and at fair value if expected to be collected in more than one year. The School considers all unconditional promises to give to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Property and equipment

Property and equipment are recorded at cost or estimated fair value for donated items. Equipment purchases over \$1,000 are capitalized. The cost of repairs and maintenance which do not improve or extend the lives of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which is 5 to 14 years. Depreciation is charged to the activity benefiting from the use of the property or equipment.

Accrued vacation

Accrued vacation represents vacation earned, but not taken as of June 30, 2018 and 2017. The accrued vacation balance as of June 30, 2018 and 2017 was \$25,756 and \$36,040, respectively.

School of Arts and Culture at MHP
Notes to Financial Statements
June 30, 2018
(With Comparative Totals for 2017)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Agency fund for scholarships

The School entered into an agreement in August 2015 with Mi Pueblo, LLC (Mi Pueblo). Under this agreement, Mi Pueblo appointed the School as an agent. This agreement was established to provide scholarship funds to college bound, graduating high school seniors. These funds are under the control of Mi Pueblo and cannot be awarded to a student without the approval of Mi Pueblo. Scholarships were awarded during the fiscal years ended June 30, 2018 and 2017 totaling \$0 and \$4,000, respectively. The cash and related liability for the agency fund for scholarships totaled \$22,445 and \$22,445 as of June 30, 2018 and 2017, respectively. Effective in the year ended June 30, 2018, the fiscal agency relationship with Mi Pueblo has ended. All remaining funds will be held until the scholarships are fully distributed to students.

Revenue recognition

The School recognizes support and revenue on the accrual basis of accounting. Revenue from grants which have been classified as "exchange transactions" and program fees are recognized as revenue in the period in which the service is provided.

Contributions

Contributions are recognized when the donor makes a pledge to give that is, in substance, an unconditional promise. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted depending on the nature of donor restrictions. Restricted contributions are reported as increases in restricted net assets. When the restriction is met the amount is shown as a reclassification of restricted net assets to unrestricted net assets.

Contributions in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. Donated space is recorded at the estimated fair value of comparable property as of the date of the donation. Contributed services, which require a specialized skill and which the School would have paid for if not donated, are recorded at the estimated fair value at the time the services are rendered.

Functional expense allocations

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and support services benefited. Indirect expense allocations are based on square footage and/or the number of full time equivalent staff members in each activity.

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4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax status

School of Arts and Culture at MHP is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701d of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying financial statements. In addition, the School qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Uncertainty in income taxes

Generally accepted accounting principles provide accounting and disclosure guidance about positions taken by an organization in its tax returns that might be uncertain. Management has considered its tax positions and believes that all of the positions taken by the School in its federal and state exempt organization tax returns are more likely than not to be sustained upon examination.

The School's federal returns could be subject to examination by federal taxing authorities, generally for 3 years after they are filed. The School's state returns could be subject to examination by state taxing authorities, generally for 4 years after they are filed.

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 assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of support, revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Advertising

The School's policy is to expense advertising costs as the costs are incurred. Advertising expense for the years ended June 30, 2018 and 2017 was \$72,487 and \$68,894, respectively.

Subsequent events

The School has evaluated events and transactions subsequent to June 30, 2018 for potential recognition or disclosure in the financial statements. The School did not have subsequent events that required recognition or disclosure in the financial statements for the year ended June 30, 2018. Subsequent events have been evaluated through the date the financial statements became available to be issued, November 26, 2018.

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5. DONATED RENT RECEIVABLE

In January 2014, the School of Arts and Culture at MHP entered into a fifteen year agreement, effective July 1, 2014, with the City of San Jose to act as the permanent operator of the Mexican Heritage Plaza. Under this agreement the School operates the Plaza for no rent and both parties may elect to extend the term of the agreement for 2 terms of ten years each (see Note 7).

As management has determined that it is unlikely that either party would terminate the agreement, during the initial fifteen year term, the School recognized the benefit of the fair value of the rent received through this agreement as donated rent receivable and temporarily restricted support. The School has established the fair market value of the rent under the agreement at \$680,955 per year. The annual rent expense is included in the statement of activities beginning with the year ended June 30, 2015. The net present value of the future contribution benefit has been computed at a discount rate of 2.2% based upon prevailing rates when the agreement was entered into and is recorded as donated rent receivable on the statement of financial position.

Donated rent receivable is expected to be received as follows:

<u>Year ending June 30,</u>		
2019	\$	540,131
2020		552,134
2021		564,404
2022		576,947
2023		589,769
Thereafter		<u>3,824,279</u>
		6,647,664
Current portion		<u>(540,131)</u>
	<u>\$</u>	<u>6,107,533</u>

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	2018	2017
Theater equipment	\$ 68,906	\$ 58,385
Leasehold improvements	48,375	48,375
Office equipment	<u>8,586</u>	<u>8,586</u>
	125,867	115,346
Accumulated depreciation	<u>(59,057)</u>	<u>(43,725)</u>
	<u>\$ 66,810</u>	<u>\$ 71,621</u>

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6. PROPERTY AND EQUIPMENT (continued)

Depreciation expense for the years ended June 30, 2018 and 2017 was \$15,332 and \$15,322, respectively.

7. MEXICAN HERITAGE PLAZA OPERATOR AND USE AGREEMENT

In January 2014, School of Arts and Culture at MHP entered into a new fifteen year agreement with the City, effective July 1, 2014 to act as the permanent operator of the Mexican Heritage Plaza. Following the expiration in June 30, 2029, both parties may elect to extend the term of the agreement for 2 terms of ten years each (see Note 5).

Under the new agreement, the quarterly operations payments to the School will be structured to match earned and contributed income raised by the School. The match will be limited to \$450,000 per year in years one to five and \$425,000 per year in years six through termination. Other terms of the match remain unchanged from the previous agreement.

Under the new agreement, annual appropriations for Capital Repairs and Capital Replacements of \$50,000 per year are earmarked for the Plaza for years one to five and \$100,000 in years six through termination. Included in this \$100,000 is \$25,000 representing a reallocation from the reduction in the operation payments and is contingent upon a City match of \$25,000.

8. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following:

	<u>2018</u>	<u>2017</u>
Purpose restrictions		
Other programs	\$ 189,002	\$ 22,651
Multicultural Arts Leadership Institute	168,334	-
Mayferia	85,000	166,668
Fiscal sponsorship	65,371	16,227
K-12 education and summer camps	<u>54,620</u>	<u>50,000</u>
	<u>562,327</u>	<u>255,546</u>
Time restrictions		
Donated rent for future periods	<u>6,647,663</u>	<u>7,176,046</u>
	<u>6,647,663</u>	<u>7,176,046</u>
	<u>\$ 7,209,990</u>	<u>\$ 7,431,592</u>

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8. TEMPORARILY RESTRICTED NET ASSETS (continued)

Temporarily restricted net assets released from restriction during the year were as follows:

	2018	2017
Purpose restrictions		
Mayferia	\$ 244,167	\$ 209,580
K-12 education and summer camps	159,080	198,710
Other programs	108,044	223,355
Fiscal sponsorship	58,379	60,175
Multicultural Arts Leadership Institute	35,000	71,530
	604,670	763,350
Time restrictions		
Donated rent for future periods	680,955	680,955
General operating	-	157,488
	\$ 1,285,625	\$ 1,601,793

9. CONFLICT OF INTEREST POLICY

Included among the School's Board of Directors and Officers are volunteers from the community who provide valuable assistance to the School in the development of policies and programs and in the evaluation of business transactions. The School has adopted a conflict of interest policy whereby Board members are disqualified from participation in the final decisions regarding any action affecting their related company or agency.

10. COMMITMENTS AND CONTINGENCIES

Grants and contracts awarded to the School of Arts and Culture at MHP are subject to the funding agencies' criteria, contract terms and regulations under which expenditures may be charged and are subject to audit under such terms, regulations and criteria. Occasionally, such audits may determine that certain costs incurred in connection with the grants do not comply with the established criteria that govern them. In such cases, the School could be held responsible for repayments to the funding agency for the costs or be subject to a reduction of future funding in the amount of the costs.

Management does not anticipate any material questioned costs for the contracts and grants administered during the period. The School would be responsible for the absorption of any over-expenditure of its restricted grants which cannot be covered by additional grant funds or contributions from other sources.

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11. CONCENTRATIONS

During the years ended June 30, 2018 and 2017, the School received 34% and 42% of its total support and revenue (including in-kind) directly from the City of San Jose. A reduction in awards of grants from the City could materially impact the services the School provides. In addition, the School of Arts and Culture at MHP maintains that it is unlikely that the City of San Jose would be able to rent the entire facility to any single tenant given the unique nature of the space and the community directive to maintain arts and cultural programming at the site.