

ZUMIX, INC.

Consolidated Financial Statements

March 31, 2009

(With Independent Auditors' Report Thereon)



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
ZUMIX, Inc.:

We have audited the accompanying consolidated statement of financial position of ZUMIX, Inc. (the Organization) as of March 31, 2009 and the related consolidated statements of activities and changes in net assets, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the management of ZUMIX, Inc. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit 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 from 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of March 31, 2009, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental schedules are presented for the purposes of additional analysis and are not a required part of the March 31, 2009 consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the March 31, 2009 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the March 31, 2009 consolidated financial statements taken as a whole.

Nardella + Taylor

November 04, 2009

ZUMIX, INC.

Consolidated Statement of Financial Position

March 31, 2009

| | |
|---|---------------------|
| Assets: | |
| Current assets: | |
| Cash and cash equivalents | \$ 205,043 |
| Accounts receivable, net of allowance for bad debts of \$2,200 | 46,064 |
| Prepaid expenses and other current assets | 5,610 |
| Total current assets | <u>256,717</u> |
| Amounts held in escrow | 2,578,334 |
| Property and equipment, net | 1,057,553 |
| Notes receivable long-term - contractual principal | 1,979,662 |
| Discount for below-market rates | (1,329,130) |
| Notes receivable long-term, net of discount | <u>650,532</u> |
| Deferred debt issuance costs, net of accumulated amortization | 241,012 |
| Deferred financing costs, net of accumulated amortization | <u>1,329,130</u> |
| Total assets | <u>\$ 6,113,278</u> |
| Liabilities and Net Assets: | |
| Current liabilities: | |
| Accounts payable and accrued expenses | \$ 30,133 |
| Note payable, short-term | <u>210,000</u> |
| Total current liabilities | <u>240,133</u> |
| Deferred income | 2,653,512 |
| Long-term mortgage notes payable - contractual principal | 3,857,892 |
| Discount for below-market rates | (2,653,512) |
| Long-term mortgage notes payable, net of discount | <u>1,204,380</u> |
| Net assets: | |
| Unrestricted | \$ 1,742,816 |
| Temporarily restricted | <u>272,437</u> |
| Total net assets | <u>2,015,253</u> |
| Total liabilities and net assets | <u>\$ 6,113,278</u> |

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

ZUMIX, INC.

Consolidated Statement of Activities and Changes in Net Assets

Year Ended March 31, 2009

| | Unrestricted | Temporarily Restricted | Total |
|--|--------------|---------------------------|--------------|
| Support and Revenue: | | | |
| Individual donations | \$ 104,617 | \$ 4,732 | \$ 109,349 |
| Corporate and foundation donations | 573,615 | 65,500 | 639,115 |
| Contributed legal services | 69,593 | 202,205 | 271,798 |
| Government grants | 93,213 | - | 93,213 |
| Program fees | 64,928 | - | 64,928 |
| Interest income | 17,865 | - | 17,865 |
| Amortization of deferred income from below-market interest rate loans | 2,701 | - | 2,701 |
| Other income | 2,685 | - | 2,685 |
| Net assets released from restrictions | 1,304,838 | (1,304,838) | - |
| Total support and revenue | 2,234,055 | (1,032,401) | 1,201,654 |
| Expenses: | | | |
| Youth programs | 336,607 | - | 336,607 |
| Community arts program | 35,045 | - | 35,045 |
| Management and general | 150,051 | - | 150,051 |
| Fundraising | 34,500 | - | 34,500 |
| Capital project | 118,505 | - | 118,505 |
| Total expenses | 674,708 | - | 674,708 |
| Increase (decrease) in net assets | 1,559,347 | (1,032,401) | 526,946 |
| Net assets at beginning of year | 183,469 | 1,304,838 | 1,488,307 |
| Net assets at end of year | \$ 1,742,816 | \$ 272,437 | \$ 2,015,253 |

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

ZUMIX, INC.

Consolidated Statement of Cash Flows

Year Ended March 31, 2009

Increase (decrease) in cash:

Cash flows from operating activities:

| | |
|--|---------------|
| Increase in net assets | \$ 526,946 |
| Adjustments to reconcile changes in net assets to net cash provided by operating activities: | |
| Contributed legal service revenue, net of amounts charged to expense | (202,205) |
| Amortization of deferred financing costs | 6,950 |
| Discount amortization on notes receivable | (6,950) |
| Amortization of unearned income | (2,701) |
| Discount amortization on notes payable | 2,701 |
| Depreciation | 2,614 |
| Decrease in accounts receivable | 95,343 |
| Increase in prepaid expenses | (216) |
| Increase in accounts payable and other current liabilities | <u>15,945</u> |

Net cash provided by operating activities 438,427

Cash flows from investing activities:

Purchases of fixed assets (961,532)

Net cash used in investing activities (961,532)

Cash flows from financing activities:

| | |
|--|------------------|
| Increase in amounts held in escrow | (2,578,334) |
| Cash exchanged for long-term notes receivable | (1,979,662) |
| Net increase in borrowings under short-term financing arrangements | 210,000 |
| Net proceeds from issuance of long-term notes payable | 3,857,892 |
| Debt issuance costs | <u>(130,000)</u> |

Net cash used in financing activities (620,104)

Net decrease in cash (1,143,209)

Cash and cash equivalents, beginning of period 1,348,252

Cash and cash equivalents, end of period \$ 205,043

Supplemental cash flow data:

| | |
|--|-------------------|
| Contributed goods and services: | |
| Volunteered legal services - charged to expense | \$ 69,593 |
| Volunteered legal services - related to land acquisition - capitalized | 91,193 |
| Volunteered legal services - related to debt issuance - capitalized | 111,012 |
| Volunteered services - other | 2,000 |
| Office and program supplies | <u>2,814</u> |
| | <u>\$ 276,612</u> |

Cash paid for interest \$ 4,036

\$ 4,036

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

ZUMIX, INC.

Consolidated Statement of Functional Expenses

Year Ended March 31, 2009

| | Youth Programs | Community Arts | Total Program Services | Management and General | Fundraising | Total Operations | Capital Project | Total |
|--|-------------------|-------------------|---------------------------|---------------------------|------------------|---------------------|--------------------|----------------|
| Salaries | \$ 136,965 | \$ 7,720 | \$ 144,685 | \$ 62,453 | \$ - | \$ 207,138 | \$ 29,030 | 236,168 |
| Youth Stipends | 11,303 | 930 | 12,233 | 200 | - | 12,433 | - | 12,433 |
| Employee benefits | 10,732 | 449 | 11,181 | 12,985 | - | 24,166 | 2,304 | 26,470 |
| Payroll taxes | 11,695 | 618 | 12,313 | 5,383 | - | 17,696 | 2,423 | 20,119 |
| Total salaries and related expenses | <u>170,695</u> | <u>9,717</u> | <u>180,412</u> | <u>81,021</u> | <u>-</u> | <u>261,433</u> | <u>33,757</u> | <u>295,190</u> |
| Consulting | 109,164 | 11,697 | 120,861 | 25,975 | 34,500 | 181,336 | 300 | 181,636 |
| Bank fees/payroll fees | 28 | - | 28 | 4,024 | - | 4,052 | 200 | 4,252 |
| Advertising | 100 | 9,537 | 9,637 | 362 | - | 9,999 | - | 9,999 |
| Bad debt | - | - | - | - | - | - | - | - |
| Supplies | 2,908 | 820 | 3,728 | 5,644 | - | 9,372 | 197 | 9,569 |
| Telephone | 4,828 | - | 4,828 | 1,118 | - | 5,946 | - | 5,946 |
| Postage and shipping | 97 | 236 | 333 | 1,299 | - | 1,632 | 34 | 1,666 |
| Rent | 16,669 | 230 | 16,899 | 4,186 | - | 21,085 | - | 21,085 |
| Equipment rental and maintenance | 5,139 | 352 | 5,491 | 1,050 | - | 6,541 | - | 6,541 |
| Printing and publications | 499 | 2,083 | 2,582 | 4,164 | - | 6,746 | 518 | 7,264 |
| Facilities maintenance and repair | 6,606 | - | 6,606 | 1,592 | - | 8,198 | - | 8,198 |
| Travel | 3,366 | 4 | 3,370 | 583 | - | 3,953 | 77 | 4,030 |
| Conferences, conventions and meetings | 3,076 | 369 | 3,445 | 7,889 | - | 11,334 | 36 | 11,370 |
| Dues and subscriptions | 1,147 | - | 1,147 | 1,727 | - | 2,874 | 38 | 2,912 |
| Insurance | 4,908 | - | 4,908 | 1,227 | - | 6,135 | - | 6,135 |
| Utilities | 7,377 | - | 7,377 | 2,038 | - | 9,415 | - | 9,415 |
| Depreciation | - | - | - | 2,614 | - | 2,614 | - | 2,614 |
| Vehicle expense | - | - | - | 3,336 | - | 3,336 | 12 | 3,348 |
| Amortization of deferred financing costs | - | - | - | - | - | - | 6,950 | 6,950 |
| Professional fees - legal | - | - | - | - | - | - | 69,593 | 69,593 |
| Interest expense | - | - | - | - | - | - | 6,737 | 6,737 |
| Other expenses | - | - | - | 202 | - | 202 | 56 | 258 |
| Total expenses | <u>\$ 336,607</u> | <u>\$ 35,045</u> | <u>\$ 371,652</u> | <u>\$ 150,051</u> | <u>\$ 34,500</u> | <u>\$ 556,203</u> | <u>\$ 118,505</u> | <u>674,708</u> |

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

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(1) Nature of Operations

ZUMIX, Inc. was incorporated on April 1, 1991 as an outreach organization offering music and arts opportunities on a year-round basis to young people ages eight to eighteen in Boston, Massachusetts. The mission of ZUMIX, Inc. is to stimulate interest in, and further understanding of music and related arts; and to build self-esteem, pride and a sense of accomplishment in young people to support charitable and educational purposes in the field of visual arts.

(2) Summary of Significant Accounting Policies

The following is a summary of significant accounting policies applied by ZUMIX, Inc. in the preparation of the accompanying financial statements. The accounting and reporting policies are in conformity with generally accepted accounting principles. ZUMIX, Inc. prepares its financial statements in accordance with Statement of Financial Accounting Standards No. 116, "Accounting for Contributions Received and Contributions Made," and No. 117, "Financial Statements of Not-for-Profit Organizations."

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of ZUMIX, Inc. and its related entity ZUMIX Firehouse, Inc. ("ZFI"). ZUMIX, Inc. has the power to appoint a voting majority of board members of ZFI and has made an equity contribution of \$166,000 to ZFI (described in further detail below). ZUMIX, Inc. has deemed that these factors together constitute both an "economic interest" and "control," requiring consolidation under the provisions of AICPA Statement of Position 94-3, "Reporting of Related Entities by Not-For-Profit Organizations." The accounts of ZUMIX Firehouse, Inc. are included as of December 31, 2008. Intercompany transactions and balances have been eliminated in consolidation.

ZUMIX Firehouse, Inc., a Massachusetts not-for-profit corporation, was formed for the purpose of purchasing and renovating the Engine Company 40 Firehouse, at 260 Sumner Street in East Boston, MA in order to turn the building into a vibrant youth arts center.

The ZUMIX Firehouse project has a total capital budget (including all New Markets Tax Credit transaction costs) of \$4,172,904 aggregated by the MHIC New Markets Fund II, LLC, ("MHIC New Markets Fund II") an investment fund managed by the Massachusetts Housing Investment Corporation ("MHIC"). It is composed of the following sources:

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(a) Principles of Consolidation (continued)

| | | |
|---|----|------------------|
| Equity investments in New Markets Tax Credits by multiple investors | \$ | 1,273,242 |
| Loan from East Boston Community Development Corporation | | 920,000 |
| Two Sponsor Loans from ZUMIX, Inc. (see Note 7) | | 1,979,662 |
| | \$ | <u>4,172,904</u> |

This pool was in turn invested in two Community Development Entities (CDEs) and used to cover MHIC New Markets Fund II, LLC's transaction costs as follows:

| | | |
|--|----|------------------|
| Investment in MHIC New Markets CDE II Series 5, LLC | \$ | 3,589,954 |
| Investment Nuestra Commercial Markets Fund 2008, LLC | | 565,000 |
| | | <u>4,154,954</u> |
| Fund transaction costs | | 17,950 |
| | \$ | <u>4,172,904</u> |

The \$4,154,954 invested in the CDEs was expended in the following manner:

Fees, third party costs and reserves:

| | | |
|--|----|------------------|
| Fees and third party costs - MHIC New Markets CDE II Series 5, LLC | \$ | 179,498 |
| Fees and third party costs - Nuestra Commercial Markets Fund 2008, LLC | | 39,550 |
| Reserves withheld by MHIC | | 78,014 |
| Total fees, third party costs and reserves | | <u>297,062</u> |
| Loans to ZUMIX Firehouse, Inc. (see Note 11): | | |
| MHIC New Markets CDE II Series 5, LLC | | 3,332,442 |
| Nuestra Commercial Commercial Markets Fund 2008, LLC | | 525,450 |
| Total Loans to ZFI | | <u>3,857,892</u> |
| | \$ | <u>4,154,954</u> |

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(a) Principles of Consolidation (continued)

Additionally, ZUMIX, Inc. has made an equity investment in ZFI of \$166,000. This equity investment plus the \$3,857,892 loaned to ZFI comprise the capital budget of \$4,023,892.

On December 17, 2008, ZFI purchased the land and building at 260 Sumner Street East Boston, MA from the previous owner. Events occurring at that date are described as having occurred "at closing."

In connection with the Firehouse project, ZFI committed to paying \$800,000 in developer fees as follows:

| | |
|--|--------------------------|
| Fee paid at closing to East Boston Community Development Corporation | \$ 320,000 |
| Fee paid at closing to ZUMIX, Inc. | 350,000 |
| Fee to be paid at completion to ZUMIX, Inc. | <u>130,000</u> |
| | <u><u>\$ 800,000</u></u> |

The \$320,000 paid at closing to East Boston Community Development Corporation ("East Boston CDC") represents a payment to this entity for managing the construction of the building.

The \$350,000 paid at closing to ZUMIX, Inc. represents a payment for management of the predevelopment process.

The \$130,000 to be paid at completion to ZUMIX, Inc. is to establish an operating reserve of \$50,000 and a debt service escrow of \$80,000.

(b) Property and Equipment

Property and equipment are recorded at cost if purchased and estimated fair market value at the time of donation if donated to the Organization. Contributed services that create or enhance long-lived assets are capitalized and recognized at the estimated fair market value at the time of donation. Expenditures for repairs and maintenance are charged to expense as incurred. When assets are retired or disposed of, the assets and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected in income. Depreciation is provided using the straight-line method over the estimated useful life of the assets, ranging from five to seven years for assets placed in service as of March 31, 2009. Land is not depreciated. The building has not yet been placed in service as of March 31, 2009 and consequently no related depreciation has been recorded.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(c) Recognition of Income and Net Asset Classification

ZUMIX, Inc. reports gifts as unrestricted support if they are received without donor stipulations which would limit the use of the donated assets. They are classified as increases in temporarily restricted net assets if the donor imposes restrictions on their use, including those for which payment is not due until future periods. Upon the satisfaction of the usage or time restriction, the net assets are reclassified as unrestricted support.

ZUMIX, Inc.'s policy is to report as unrestricted support contributions with donor-imposed restrictions when these restrictions are met in the same year that the contribution was received.

Contributions of long-lived assets (including enhancements to long-lived fixed assets) and amounts restricted for the purchase of long-lived assets, for which the donor does not specify a particular period of use, are treated as increases in temporarily restricted net assets when received and re-classified as unrestricted at the time the asset is placed in service.

ZUMIX, Inc.'s contributions come primarily from the general public, private foundations, corporations and certain governmental agencies.

(d) Cash and Cash Equivalents

For the purpose of the statement of cash flows, ZUMIX, Inc. considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Certain grants require the organization to hold cash in separate bank accounts. The total amount of cash held in separate accounts is \$222 as of March 31, 2009.

(e) Concentration of Credit Risk

Financial instruments which subject ZUMIX, Inc. to credit risk consist principally of temporary cash investments and amounts held in escrow. Temporary cash investments may at times exceed amounts insured by the FDIC. ZUMIX, Inc. places its temporary cash investments with high quality financial institutions. At March 31, 2009 balances in cash and temporary cash investment accounts did not exceed the amount insured by the FDIC.

Amounts held in escrow are held in a single depository institution and exceeded FDIC insured limits by \$2,328,334 at March 31, 2009.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(f) Income Taxes

ZUMIX, Inc. is a not-for-profit organization under Section 501(c)(3) of the Internal Revenue Code and is exempt from income tax.

ZUMIX, Inc. has adopted FASB Staff Position No. FIN 48-3, which allows certain nonpublic entities to defer the effective date of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), until the annual financial statements for fiscal years beginning after December 15, 2008. ZUMIX, Inc. has elected to apply the deferral and will adopt the provisions of FIN 48 effective for the annual financial statements for the year ending March 31, 2010.

ZUMIX, Inc.'s accounting policy for evaluating uncertain tax positions during financial statement periods subject to the deferral of FIN 48 is based on the recognition and disclosure criteria for loss contingencies under SFAS No. 5, "Accounting for Contingencies."

(g) Estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(h) Advertising Costs

ZUMIX, Inc. expenses advertising costs as they are incurred. Advertising expense was \$9,999 for the year ended March 31, 2009.

(i) Fair Value Measurements

The carrying value of financial instruments in the financial statements approximates fair value.

On April 1, 2008, ZUMIX, Inc. adopted the provisions of Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157), for fair value measurements of financial assets and financial liabilities, and for fair value measurements of non-financial items that are recognized and disclosed at fair value in the financial statements on a recurring basis. SFAS 157 defines fair value 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.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(i) Fair Value Measurements (continued)

SFAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. SFAS 157 establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Organization. Unobservable inputs reflect the Organization's assumptions 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 is categorized into three levels based on the inputs as follows:

- Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Organization has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. Since valuations are based on quoted prices that are readily available and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.
- Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

FASB Staff Position 157-2, "Effective Date of FASB Statement No.157," delays the effective date of SFAS 157 until fiscal years beginning after November 15, 2008 for all non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. ZUMIX, Inc. will be required to apply these provisions beginning on April 1, 2009, and is in the process of evaluating their impact.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(j) Debt Issuance Costs

Debt issuance costs include amounts paid by the Organization in connection with the issuance of long-term mortgage notes payable issued in December of 2008 to finance the Firehouse project, as well as the fair value of contributed legal services directly allocable to the issuance of these notes. Amortization of debt issuance costs is calculated using the straight-line method over the 30-year term of the notes. As of March 31, 2009, no amortization expense has been recorded in the consolidated financial statements. ZUMIX, Inc. will begin recognizing amortization expense related to debt issuance costs in the consolidated financial statements during the year ending March 31, 2010.

The Organization's policy is to recognize contributed legal services capitalized as debt issuance costs as an increase in temporarily restricted net assets when received. As the contributed debt issuance costs are amortized into expense the Organization simultaneously recognizes a corresponding decrease in temporarily restricted net assets and an equal increase in unrestricted net assets.

(3) Commitments

ZUMIX, Inc. leases office and studio space in East Boston, Massachusetts under a tenant at-will agreement. The annual rent expense amounted to \$20,680 for the year ended March 31, 2009.

(4) Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following as of March 31, 2009:

| | | |
|--|----|----------------|
| Contributed debt issuance costs to be amortized in future periods | \$ | 111,012 |
| Contributed long-lived fixed asset additions to be placed in service | | 91,193 |
| Program activities | | 70,232 |
| | \$ | <u>272,437</u> |

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(4) Temporarily Restricted Net Assets (continued)

Net assets of \$1,304,838 were released from donor restrictions by incurring expenses satisfying the purpose or time restrictions specified by donors as follows:

| | <u>2009</u> |
|------------------------------------|---------------------|
| Time Restrictions | <u>\$ 37,500</u> |
| Purpose restrictions accomplished: | |
| Capital project related | \$ 1,134,663 |
| Youth programs | 117,675 |
| Community Arts | <u>15,000</u> |
| | <u>1,267,338</u> |
| | <u>\$ 1,304,838</u> |

(5) Accounts Receivable

Accounts receivable are stated at the amounts management expects to collect from outstanding balances. Based on management's assessment of the credit history with donors having outstanding balances, and current relationships with them, it has been determined that realization losses on balances outstanding at year-end are immaterial.

All accounts receivable at March 31, 2009 were expected to be collected in less than one year.

(6) Amounts Held in Escrow

An amount of \$2,578,334 is held in escrow by MHIC exclusively for future costs of the development of the firehouse property. These funds will be disbursed to finance approved costs that have been incurred. Because these funds are set aside for the purchase of long-lived assets, the amount held in escrow is classified as non-current in the consolidated statement of financial position.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(7) Long-Term Notes Receivable, Net

ZUMIX, Inc. has made two sponsor loans, totaling \$1,979,662 to MHIC New Markets Fund II in exchange for notes receivable (as described in the following table). The proceeds of these loans were used by MHIC New Markets Fund II for the purpose of making Qualified Equity Investments of \$1,587,757 and \$391,805, in MHIC New Markets CDE II Series 5, LLC and Nuestra Commercial Markets Fund 2008, LLC respectively. These respective entities subsequently used these funds for making 0% stated interest rate loans to ZUMIX Firehouse, Inc. of \$1,587,737 and \$391,805. The financing was structured in this manner in order to increase the amount of Qualified Equity Investment in MHIC New Markets Fund II to \$4,172,904 - thereby increasing the dollar amount of New Markets Tax Credits allocable to equity investors to a total of approximately \$1.6 million.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(7) Long-Term Notes Receivable, Net (continued)

Long-term notes receivable are as follows at March 31:

| | <u>2009</u> |
|--|-------------------|
| Contractual amounts receivable (face amounts): | |
| Tranche A note receivable from MHIC New Markets Fund II with a stated interest rate of 0%. Under loan agreement, ZUMIX, Inc. is to receive monthly payments of \$5,293 beginning November, 2017 with the balance of note payable to ZUMIX, Inc. due at the December 2038 maturity date | \$ 1,587,857 |
| Tranche B note receivable from MHIC New Markets Fund II, stated interest rate of 0%, face value of note payable to ZUMIX, Inc. December 2038 | <u>391,805</u> |
| | 1,979,662 |
| Less unamortized discounts for below-market rate loans: | |
| Tranche A note receivable from MHIC New Markets Fund II (calculated using imputed effective interest rate of 5.38%) | (1,019,590) |
| Tranche B Note receivable from MHIC New Markets Fund II (calculated using imputed effective interest rate of 5.38%) | <u>(309,540)</u> |
| | (1,329,130) |
| Long-term notes receivable, net of discount | <u>\$ 650,532</u> |

It is the Organization's intent to use the proceeds received from these notes receivable agreements to repay the Organization's long-term first mortgages (as described in Note 11). Accordingly these assets are considered to have been set aside for the repayment of long-term debt.

Interest income for the year ended March 31, 2009 includes \$6,950 which represents the amortization of the original issue discounts on long-term notes receivable.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(8) Deferred Financing Costs

Deferred financing costs of \$1,329,130 (net of \$6,950 of accumulated amortization) represent the asset deemed to have been received by ZUMIX, Inc. in exchange for accepting the Tranche A and Tranche B notes receivable at below-market interest rates. ZUMIX, Inc.'s policy is to amortize deferred financing costs ratably over the life of the associated notes receivable using the effective interest method.

(9) Property and Equipment

A summary of property and equipment at March 31, 2009 follows:

| | |
|------------------------------------|--------------|
| Motor vehicle | \$ 2,971 |
| Furniture and fixtures | 11,588 |
| Computer equipment | 54,203 |
| Land | 227,998 |
| Building | 212,519 |
| | <hr/> |
| | 509,279 |
| Less accumulated depreciation | (63,934) |
| Construction in progress | 612,208 |
| Property, plant and equipment, net | <hr/> <hr/> |
| | \$ 1,057,553 |

ZUMIX, Inc. has commitments to expend approximately \$2,578,334 to complete the renovation of the Engine Company 40 Firehouse in East Boston, which it will use for office space and program activities.

(10) Note Payable, Short-Term

During the year ended March 31, 2009 the Organization borrowed \$500,000 under a short-term note payable agreement. The proceeds of this note were used by ZUMIX, Inc. for the purpose of making the \$166,000 equity investment in ZFI and for financing \$334,000 of the total \$1,979,662 of funds loaned by ZUMIX, Inc. to MHIC New Markets Fund II. The note bears interest at an amount equal to the Wall Street Journal Prime Rate, floating plus 1% (4.25% per annum at March 31, 2009), payable monthly. At March 31, 2009 the outstanding principal balance on this note was \$210,000. No principal payments are due until maturity (December 1, 2009). The note is secured by all current and future pledges, contributions, commitments or donations to Zumix, Inc. for the Firehouse Project and Property, excluding pledges or donations restricted for the Borrower's programs and general operations, in an amount not to exceed the loan.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(11) Long-Term Mortgage Notes Payable

Long-term mortgage notes payable are as follows at March 31:

| | <u>2009</u> |
|--|---------------------|
| 0% note payable to MHIC New Markets CDE II Series 5, LLC. Secured by a shared first mortgage and security interest in land and building, carrying value of \$1,052,725 (including \$612,208 of construction in progress). Monthly payments of \$5,394 due beginning November 2017 through December 2038 (maturity date). | \$ 1,587,757 |
| 0% note payable to Nuestra Commercial Markets Fund 2008, LLC Secured by a shared first mortgage and security interest in land and building, carrying value of \$1,052,725 (including \$612,208 of construction in progress). All principal payable at maturity (December 2038). | 391,805 |
| 0.50% Note payable to MHIC New Markets CDE II Series 5, LLC. Secured by a shared second mortgage and security interest in land and building, carrying value of \$1,052,725 (including \$612,208 of construction in progress). Payments of interest only in arrears, calculated using the stated interest rate applied to the outstanding principal balance are due monthly. Monthly payments of principal only of \$2,749 are due beginning November 2017 through December 2038 (maturity date), balance of principal due at maturity. | 824,685 |
| 1.50% Note payable to Nuestra Commercial Markets Fund 2008, LLC. Secured by a shared second mortgage and security interest in land and building, carrying value of \$1,052,725 (including \$612,208 of construction in progress). Payments of interest only in arrears, calculated using the stated interest rate applied to the outstanding principal balance are due monthly. All principal payable at maturity (December 2038). | 133,645 |
| 0% Note Payable to MHIC New Markets CDE II Series 5, LLC secured by a third mortgage and security interest in land building, carrying values of \$1,052,725 (including \$612,208 of construction in progress). Payments of \$3,067 due monthly beginning November 2017, balance of principal payable at maturity (December 2038). Guaranteed by East Boston CDC. | 920,000 |
| | <u>3,857,892</u> |
| Discount for imputed interest on below-market interest rate loans | (2,653,512) |
| Long-term notes payable, net | <u>\$ 1,204,380</u> |

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(11) Long-Term Mortgage Notes Payable (continued)

A discount on below-market interest loans is imputed using interest rates ranging from 5.38% to 8.34%.

Interest expense related to the amortization of discounts on long-term notes payable was \$2,701 for the year ended March 31, 2009.

Under the terms of each of the respective long-term note payable agreements, ZUMIX, Inc. will incur a prepayment penalty should it elect to repay amounts of principal on or before a specified lockout date of December 18, 2016 (the "Lockout Date"). The prepayment penalty is equal to the amount of all interest that would have been payable on the outstanding principal balance of each respective note (for which prepayment is made) from the date of prepayment to the Lockout Date calculated at a rate of 20% per annum.

Future maturities of long-term debt are as follows for the years ended March 31:

| | | |
|------------|----|-------------------------|
| 2010 | \$ | - |
| 2011 | | - |
| 2012 | | - |
| 2013 | | - |
| 2014 | | - |
| Thereafter | | <u>3,857,892</u> |
| Total | \$ | <u><u>3,857,892</u></u> |

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(12) Deferred Income

In connection with the purchase and renovation of the firehouse, the Organization entered into several long-term debt financing agreements by borrowing cash in the amount of \$3,857,892 and issuing long-term notes payable with a face amounts totaling \$3,857,892 (see Note 11). The Organization's policy is to report long-term notes payable at the net present value at the time of issuance, net of any amortized discount or premium. In accordance with this policy, management recorded discounts on these notes payable amounting to \$2,565,213 at the time of their issuance, as the Organization deemed the stated interest rates on these notes to be below market rates at that time. In connection with the receipt of this below-market financing the Organization also recognized deferred income in the amount of \$2,656,213 which the Organization will amortize into income over the lives of the notes using the effective interest rate method. Amortization of deferred income was \$2,701 for the year ended March 31, 2009.

(13) Credit Card Line of Credit

ZUMIX, Inc. has a business line of credit available from a credit card company allowing for purchases or cash borrowings. At March 31, 2009, the Organization had no outstanding cash borrowings and had an outstanding balance from purchases of \$1,958. At March 31, 2009, the Organization had remaining credit available for purchases of \$14,842 and \$5,600 for cash advances. Minimum monthly payments, which vary according to the outstanding balances, are due under the agreement including interest at 14.99% for purchases and 21.99% for cash advances, at March 31, 2009.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(14) Assets and Liabilities Measured at Fair Value:

Certain financial assets and liabilities are measured at fair value on a non-recurring basis and are included below. The amounts below represent only balances measured at fair value during the period and still held as of the reporting date.

| <u>Description</u> | March 31 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable inputs (Level 3) |
|---|---------------------|---|---|--|
| Assets | | | | |
| Notes receivable long-term, net of discount | \$ 650,532 | \$ - | \$ 650,532 | \$ - |
| Total assets | <u>\$ 650,532</u> | <u>\$ -</u> | <u>\$ 650,532</u> | <u>\$ -</u> |
| Liabilities | | | | |
| Long-term mortgage notes payable, net of discount | \$ 1,204,380 | \$ - | \$ 644,801 | \$ 559,579 |
| Total liabilities | <u>\$ 1,204,380</u> | <u>\$ -</u> | <u>\$ 644,801</u> | <u>\$ 559,579</u> |

When determining the fair values of long-term notes payable and receivable, management considers the following observable and verifiable inputs: timing of contractual cash flows, and published interest rates on mortgages of similar length. Other significant unobservable inputs include the effects on interest rates that management has estimated based on collateral and guarantee provisions as well as subordination features.

Because 30-year fixed mortgage rates are observable and verifiable management has classified its first mortgage notes payable as liabilities falling into level 2 of the fair value hierarchy established by SFAS 157.

Because the notes receivable have essentially the same features as the first mortgage notes payable, management has classified these amounts as assets falling into level 2 of the fair value hierarchy established by SFAS 157.

Due to the lack of observable and verifiable market rate data for subordinated loans, as well as the significance of assumptions about the effect that that guarantee and collateral provisions would have on the interest rate of such loans, the Organization has classified its second and third mortgage loans as liabilities falling within level 3 of the fair value hierarchy established by SFAS 157.

ZUMIX, INC.

Notes to Consolidated Financial Statements

March 31, 2009

(15) Subsequent Event

On July 1, 2009 ZUMIX Firehouse, Inc. was granted tax exempt status by the IRS, under section 501(c) (3) of the Internal Revenue Code. The effective date of ZFI's tax exemption is June 12, 2008.

ZUMIX, INC.

Supplemental Consolidating Schedule of Financial Position

March 31, 2009

| | ZUMIX, Inc. | ZUMIX Firehouse, Inc. | Elimination | Consolidated |
|---|---------------------|--------------------------|---------------------|---------------------|
| Assets: | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 205,000 | \$ 43 | \$ - | \$ 205,043 |
| Accounts receivable, net of allowance for bad debts of \$2,200 | 46,064 | - | - | 46,064 |
| Prepaid expenses and other current assets | 5,610 | - | - | 5,610 |
| Due from affiliate | - | 5,000 | (5,000) | - |
| Total current assets | <u>256,674</u> | <u>5,043</u> | <u>(5,000)</u> | <u>256,717</u> |
| Amounts held in escrow | - | 2,578,334 | - | 2,578,334 |
| Property and equipment, net | 4,828 | 1,408,725 | (356,000) | 1,057,553 |
| Notes receivable long-term - contractual principal | 1,979,662 | - | - | 1,979,662 |
| Discount for below-market rates | (1,329,130) | - | - | (1,329,130) |
| Notes receivable long-term, net of discount | <u>650,532</u> | <u>-</u> | <u>-</u> | <u>650,532</u> |
| Deferred debt issuance costs, net of accumulated amortization | - | 241,012 | - | 241,012 |
| Deferred financing costs, net of accumulated amortization | 1,329,130 | - | - | 1,329,130 |
| | - | - | - | - |
| Interest in the net assets of ZUMIX Firehouse, Inc. | <u>166,000</u> | <u>-</u> | <u>(166,000)</u> | <u>-</u> |
| Total assets | <u>\$ 2,407,164</u> | <u>\$ 4,233,114</u> | <u>\$ (527,000)</u> | <u>\$ 6,113,278</u> |
| Liabilities and Net Assets: | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | \$ 23,060 | \$ 7,073 | \$ - | \$ 30,133 |
| Due to affiliate | 5,000 | - | (5,000) | - |
| Note payable, short-term | 210,000 | - | - | 210,000 |
| Total current liabilities | <u>238,060</u> | <u>7,073</u> | <u>(5,000)</u> | <u>240,133</u> |
| Deferred income | - | 2,653,512 | - | 2,653,512 |
| Long-term mortgage notes payable - contractual principal | - | 3,857,892 | - | 3,857,892 |
| Discount for below-market rates | - | (2,653,512) | - | (2,653,512) |
| Long-term mortgage notes payable, net of discount | <u>-</u> | <u>3,857,892</u> | <u>-</u> | <u>1,204,380</u> |
| Net assets: | | | | |
| Unrestricted net assets | \$ 2,098,872 | \$ (56) | \$ (356,000) | \$ 1,742,816 |
| Temporarily restricted net assets | 70,232 | 368,205 | (166,000) | 272,437 |
| Total net assets | <u>2,169,104</u> | <u>368,149</u> | <u>(522,000)</u> | <u>2,015,253</u> |
| Total liabilities and net assets | <u>\$ 2,407,164</u> | <u>\$ 4,233,114</u> | <u>\$ (527,000)</u> | <u>\$ 6,113,278</u> |

ZUMIX, INC.

Supplemental Consolidating Schedule of Activities and Changes in Net Assets

Year Ended March 31, 2009

| | ZUMIX, Inc. | | | ZUMIX Firehouse, Inc. | | | Elimination | Consolidated |
|---|---------------------|---------------------------|---------------------|-----------------------|---------------------------|-------------------|---------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Total | Unrestricted | Temporarily Restricted | Total | | |
| Support and Revenue: | | | | | | | | |
| Individual donations | \$ 104,617 | \$ 4,732 | \$ 109,349 | \$ - | \$ - | \$ - | \$ - | \$ 109,349 |
| Corporate and foundation donations | 573,615 | 65,500 | 639,115 | - | - | - | - | 639,115 |
| Contributed legal services | - | - | - | 69,593 | 202,205 | 271,798 | - | 271,798 |
| Government grants | 93,213 | - | 93,213 | - | - | - | - | 93,213 |
| Program fees | 64,928 | - | 64,928 | - | - | - | - | 64,928 |
| Interest income | 17,865 | - | 17,865 | - | - | - | - | 17,865 |
| Amortization of deferred income | | | | | | | | |
| from below-market interest rate loans | - | - | - | 2,701 | - | 2,701 | - | 2,701 |
| Developer fee | 356,000 | - | 356,000 | - | - | - | (356,000) | - |
| Other income | 2,685 | - | 2,685 | - | - | - | - | 2,685 |
| Net assets released from restrictions | 1,304,838 | (1,304,838) | - | - | - | - | - | - |
| Total support and revenue | 2,517,761 | (1,234,606) | \$ 1,283,155 | \$ 72,294 | \$ 202,205 | \$ 274,499 | \$ (356,000) | \$ 1,201,654 |
| Expenses: | | | | | | | | |
| Youth programs | 336,607 | - | 336,607 | - | - | - | - | 336,607 |
| Community arts program | 35,045 | - | 35,045 | - | - | - | - | 35,045 |
| Management and general | 150,051 | - | 150,051 | - | - | - | - | 150,051 |
| Fundraising | 34,500 | - | 34,500 | - | - | - | - | 34,500 |
| Capital project | 46,155 | - | 46,155 | 72,350 | - | 72,350 | - | 118,505 |
| Total expenses | 602,358 | - | 602,358 | 72,350 | - | 72,350 | - | 674,708 |
| Increase (decrease) in net assets from operations: | 1,915,403 | (1,234,606) | 680,797 | (56) | 202,205 | 202,149 | (356,000) | 526,946 |
| Receipt of cash from ZUMIX, Inc. | | | | | | | | |
| in exchange for interest in net assets | - | - | - | - | 166,000 | 166,000 | (166,000) | - |
| Change in net assets | 1,915,403 | (1,234,606) | 680,797 | (56) | 368,205 | 368,149 | (522,000) | 526,946 |
| Net assets at beginning of year | 183,469 | 1,304,838 | 1,488,307 | - | - | - | - | 1,488,307 |
| Net assets at end of year | \$ 2,098,872 | \$ 70,232 | \$ 2,169,104 | \$ (56) | \$ 368,205 | \$ 368,149 | \$ (522,000) | \$ 2,015,253 |