

ZUMIX, INC. AND AFFILIATE

Consolidated Financial Statements

March 31, 2014 and 2013

(With Independent Auditors' Report Thereon)



INDEPENDENT AUDITORS' REPORT

To the Board of Directors
ZUMIX, Inc.:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ZUMIX, Inc. (the "Organization") and its affiliate (ZUMIX Firehouse, Inc.). These comprise the consolidated statements of financial position as of March 31, 2014 and 2013, the related consolidated statements of cash flows for the years then ended, the related consolidated statements of activities and changes in net assets and functional expenses for the year ended March 31, 2014, 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of March 31, 2014 and 2013, and the change in its net assets and their cash flows for the year ended March 31, 2014 in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating statement of financial position as of March 31, 2014, the supplementary consolidating statement of activities and changes in net assets for the year then ended and the supplementary consolidating statement of cash flows for the year then ended are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Report on Summarized Comparative Information

We have previously audited the Organization's March 31, 2013 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated September 6, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended March 31, 2013 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Nardella + Taylor LLP

October 30, 2014

ZUMIX, INC. AND AFFILIATE

Consolidated Statements of Financial Position

March 31, 2014 and 2013

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|---------------------|
| <i>Assets</i> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 577,001 | \$ 654,753 |
| Amounts held for others | 15,403 | 556 |
| Contributions receivable, net | 138,333 | 172,503 |
| Prepaid expenses and other current assets | 29,434 | 16,137 |
| Total current assets | <u>760,171</u> | <u>843,949</u> |
| Contributions receivable, net of current portion | - | 75,000 |
| Amounts held in escrow | 130,000 | 130,000 |
| Property and equipment, net | 3,338,086 | 3,489,205 |
| Notes receivable, net | 845,193 | 802,057 |
| Deferred debt issuance costs, net | 200,842 | 208,876 |
| Deferred financing costs, net | 1,134,369 | 1,177,505 |
| Total assets | <u>\$ 6,408,661</u> | <u>\$ 6,726,592</u> |
| <i>Liabilities and Net Assets</i> | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 72,693 | \$ 44,348 |
| Amounts held for others | 15,403 | 556 |
| Total current liabilities | <u>88,096</u> | <u>44,904</u> |
| Deferred income | 2,313,249 | 2,398,523 |
| Mortgage notes payable, net | 1,544,643 | 1,459,369 |
| Total liabilities | <u>3,945,988</u> | <u>3,902,796</u> |
| Net assets: | | |
| Unrestricted | 2,231,362 | 2,476,768 |
| Temporarily restricted | 231,311 | 347,028 |
| Total net assets | <u>2,462,673</u> | <u>2,823,796</u> |
| Total liabilities and net assets | <u>\$ 6,408,661</u> | <u>\$ 6,726,592</u> |

The accompanying notes are an integral part of these financial statements

ZUMIX, INC. AND AFFILIATE

Consolidated Statement of Activities and Changes in Net Assets

For the Year Ended March 31, 2014 (With Comparative Totals for 2013)

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Total 2014</u> | <u>Total 2013</u> |
|---------------------------------------|---------------------|-----------------------------------|-----------------------|-----------------------|
| Support and revenue: | | | | |
| Individual donations | \$ 71,110 | \$ - | \$ 71,110 | \$ 54,892 |
| In-kind donations | 27,685 | - | 27,685 | 81,330 |
| Corporate donations | 26,709 | - | 26,709 | 10,845 |
| Foundation donations | 415,791 | 62,875 | 478,666 | 591,235 |
| Events | 43,696 | - | 43,696 | 65,667 |
| Government grants | 44,994 | - | 44,994 | 42,917 |
| Program fees | 145,704 | - | 145,704 | 119,766 |
| Interest income | 48,415 | - | 48,415 | 46,235 |
| Amortization of deferred income | | | | |
| from below-market interest rate loans | 85,275 | - | 85,275 | 80,052 |
| Rental income | 25,950 | - | 25,950 | 27,073 |
| Sale of product | 2,811 | - | 2,811 | 2,669 |
| Net assets released from restriction | 178,592 | (178,592) | - | - |
| | <u>1,116,732</u> | <u>(115,717)</u> | <u>1,001,015</u> | <u>1,122,681</u> |
| Total support and revenue | | | | |
| Expenses: | | | | |
| Youth programs | 1,006,351 | - | 1,006,351 | 967,307 |
| Community arts program | 101,561 | - | 101,561 | 81,930 |
| Total program expenses | <u>1,107,912</u> | <u>-</u> | <u>1,107,912</u> | <u>1,049,237</u> |
| Management and general | 163,402 | - | 163,402 | 156,594 |
| Fundraising | 90,824 | - | 90,824 | 76,646 |
| | <u>1,362,138</u> | <u>-</u> | <u>1,362,138</u> | <u>1,282,477</u> |
| Total expenses | | | | |
| Decrease in net assets | (245,406) | (115,717) | (361,123) | (159,796) |
| Net assets, beginning of year | <u>2,476,768</u> | <u>347,028</u> | <u>2,823,796</u> | <u>2,983,592</u> |
| Net assets, end of year | <u>\$ 2,231,362</u> | <u>\$ 231,311</u> | <u>\$ 2,462,673</u> | <u>\$ 2,823,796</u> |

The accompanying notes are an integral part of these financial statements

ZUMIX, INC. AND AFFILIATE

Consolidated Statement of Functional Expenses

For the Year Ended March 31, 2014 (With Comparative Totals for 2013)

| | Youth Programs | Community Arts | Total Program Services | Management and General | Fundraising | 2014 Totals | 2013 Totals |
|--|---------------------|-------------------|------------------------------|------------------------------|------------------|---------------------|---------------------|
| Salaries | \$ 352,892 | \$ 47,470 | \$ 400,362 | \$ 38,056 | \$ 55,392 | \$ 493,810 | \$ 431,426 |
| Youth stipends | 15,509 | 6,151 | 21,660 | - | 1,814 | 23,474 | 25,620 |
| Employee benefits | 23,928 | 2,802 | 26,730 | 11,622 | 4,751 | 43,103 | 30,318 |
| Payroll taxes | 30,043 | 3,978 | 34,021 | 3,289 | 4,732 | 42,042 | 37,605 |
| Total salaries and related expenses | 422,372 | 60,401 | 482,773 | 52,967 | 66,689 | 602,429 | 524,969 |
| Consulting | 200,364 | 22,142 | 222,506 | 28,517 | - | 251,023 | 273,874 |
| Professional development | 5,988 | - | 5,988 | 1,313 | 3,650 | 10,951 | 11,465 |
| Bank fees and payroll fees | 203 | - | 203 | 7,550 | 33 | 7,786 | 6,920 |
| Advertising | 1,181 | 1,472 | 2,653 | 114 | 848 | 3,615 | 2,362 |
| Marketing and printing | 3,766 | 4,694 | 8,460 | 362 | 2,706 | 11,528 | 17,139 |
| Bad debt expense | 400 | - | 400 | - | - | 400 | 750 |
| Supplies | 10,184 | 901 | 11,085 | 666 | 321 | 12,072 | 7,931 |
| Telephone | 9,174 | 862 | 10,036 | 954 | 513 | 11,503 | 12,494 |
| Postage and shipping | 1,730 | 323 | 2,053 | 642 | 681 | 3,376 | 2,268 |
| Rent | 1,161 | - | 1,161 | 50 | 50 | 1,261 | 2,429 |
| Equipment rental and maintenance | 13,884 | 883 | 14,767 | 702 | 618 | 16,087 | 23,619 |
| Facilities maintenance and repair | 44,629 | 5,805 | 50,434 | 2,885 | 1,253 | 54,572 | 25,061 |
| Travel | 7,579 | 198 | 7,777 | 270 | - | 8,047 | 12,971 |
| Meetings | 6,412 | 1,348 | 7,760 | 3,425 | 1,335 | 12,520 | 12,219 |
| Insurance | 10,716 | 422 | 11,138 | 2,068 | 211 | 13,417 | 12,290 |
| Utilities | 16,094 | 2,066 | 18,160 | 1,295 | 1,209 | 20,664 | 18,527 |
| Depreciation | 160,764 | - | 160,764 | 11,010 | 5,731 | 177,505 | 179,698 |
| Vehicle expense | 180 | 44 | 224 | 474 | - | 698 | 237 |
| Interest expense | 89,570 | - | 89,570 | 48,138 | 4,976 | 142,684 | 135,254 |
| | \$ 1,006,351 | \$ 101,561 | \$ 1,107,912 | \$ 163,402 | \$ 90,824 | \$ 1,362,138 | \$ 1,282,477 |

The accompanying notes are an integral part of these financial statements

ZUMIX, INC. AND AFFILIATE

Consolidated Statements of Cash Flows

For the Years Ended March 31, 2014 and 2013

| | 2014 | 2013 |
|---|--------------|--------------|
| Cash flows from operating activities: | | |
| Decrease in net assets | \$ (361,123) | \$ (159,796) |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: | | |
| Amortization of deferred financing and debt issuance costs | 51,170 | 48,968 |
| Amortization of discount on notes receivable | (43,136) | (40,934) |
| Amortization of deferred income | (85,275) | (80,052) |
| Amortization of discount on mortgage notes payable | 85,275 | 80,052 |
| Depreciation | 177,505 | 179,698 |
| Contributed property and equipment | (10,231) | (18,237) |
| Changes in operating assets and liabilities: | | |
| Decrease in contributions receivable | 109,170 | 118,978 |
| Increase in prepaid expenses | (13,297) | (7,847) |
| Increase (decrease) in accounts payable and accrued expenses | 28,345 | (4,446) |
| Net cash provided by (used in) operating activities | (61,597) | 116,384 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (16,155) | (34,245) |
| Net cash used in investing activities | (16,155) | (34,245) |
| Net increase (decrease) in cash and cash equivalents | (77,752) | 82,139 |
| Cash and cash equivalents, beginning of year | 654,753 | 572,614 |
| Cash and cash equivalents, end of year | \$ 577,001 | \$ 654,753 |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | |
| Contributions of equipment | \$ 10,231 | \$ 18,237 |
| Contributions of supplies and items for sale | 17,454 | 63,093 |
| | \$ 27,685 | \$ 81,330 |
| Cash paid for interest | \$ 4,574 | \$ 6,230 |

The accompanying notes are an integral part of these financial statements

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

1. Nature of Operations

ZUMIX, Inc. (the “Organization” or “ZUMIX”) is a non-profit cultural organization located in East Boston, MA. ZUMIX’s mission is empowered youth who use music to make strong positive change in their lives, their communities, and the world. As a nationally recognized youth arts organization, ZUMIX uses top-quality music and cultural programming as a tool for youth development and community cohesion.

1990 marked the worst year of gang violence in Boston’s history. 152 homicides were recorded – many of the victims and perpetrators were youth. ZUMIX was incorporated on April 1, 1991 in response to this wave of violence. It began with 24 youth, \$200, and the simple idea: that giving youth something to be passionate about could change lives and elevate a community. ZUMIX’s original programs were designed to involve youth in open dialogue around societal issues as inspiration for songwriting, and public performance.

From its modest beginnings, ZUMIX has grown and expanded with the changing needs of its constituents. ZUMIX’s program model uses music to engage youth in personal development, artistic growth and community engagement, and to teach 21st century skills needed to achieve success as an adult. In 2011, ZUMIX received the National Arts and Humanities Youth Programs Award from First Lady Michelle Obama.

Recent ZUMIX highlights include the following:

- During the year ended March 31, 2014, the Organization served over 1,000 youth through after-school programming and in-school partnerships.
- During the year ended March 31, 2014, ZUMIX was one of the largest funded organizations in the EdVestors BPS Arts Expansion portfolio. This support enabled ZUMIX to provide on-site classes in poetry, percussion, radio journalism and media communications at East Boston High School and group piano, guitar and vocal instruction at Mario Umana Academy’s middle school.
- During the year ended March 31, 2014, ZUMIX youth applied the creative skills learned at ZUMIX in real-life work settings, collectively earning over \$29,000 as live sound technicians, performing musicians, radio journalists, teaching assistants, and youth staff.
- During the four year period from April 1, 2010 to March 31, 2014, 98% of ZUMIX seniors graduated from high school and 91% were accepted to college.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies

Basis of Accounting

The financial statements were prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Basis of Presentation

The Organization is required to report information regarding 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 represent amounts without donor-imposed time or purpose restrictions as of the reporting date. Temporarily restricted net assets represent amounts received with donor-imposed time restrictions that have not yet expired or donor-imposed purpose restrictions which have not yet been satisfied by the Organization. Permanently restricted net assets represent amounts with donor-imposed restrictions requiring those amounts to be held in perpetuity. None of the Organization’s net assets are classified as permanently restricted as of March 31, 2014 and 2013.

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Comparative Financial Information

The financial statements include certain prior-year summarized comparative financial information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the Organization’s financial statements for the year ended March 31, 2013, from which the summarized information was derived.

Principles of Consolidation

The consolidated financial statements include the accounts of the Organization and its related entity ZUMIX Firehouse, Inc. (“ZFI”). The Organization 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). Management has deemed that these factors together constitute both an “economic interest” and “control,” requiring consolidation under GAAP. The accounts of ZFI are included as of December 31, 2013 and 2012. All significant intercompany transactions and balances have been eliminated in consolidation.

ZFI, 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 (the “Firehouse Property”) in order to turn the building into a vibrant youth arts center.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies (Continued)

Principles of Consolidation (Continued)

The Firehouse Property project had 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:

| | |
|---|----------------------------|
| Equity investments in New Markets Tax Credits by multiple investors | \$ 1,273,242 |
| Loan from East Bost Community Development Corporation | 920,000 |
| Two sponsor loans from the Organization | <u>1,979,662</u> |
| | <u><u>\$ 4,172,904</u></u> |

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

| | |
|---|----------------------------|
| Investment in MHIC New Markets CDE II Series 5, LLC | \$ 3,589,954 |
| Investment in Nuestra Commercial Markets Fund 2008, LLC | <u>565,000</u> |
| | 4,154,954 |
| Fund transaction costs | <u>17,950</u> |
| | <u><u>\$ 4,172,904</u></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 | <u>78,014</u> |
| Total fees, third party costs and reserves | <u>297,062</u> |
| Loans to ZFI: | |
| MHIC New Markets CDE II Series 5, LLC | 3,332,442 |
| Nuestra Commercial Markets Fund 2008, LLC | <u>525,450</u> |
| Total loans to ZFI (Note 8) | <u>3,857,892</u> |
| | <u><u>\$ 4,154,954</u></u> |

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies (Continued)

Principles of Consolidation (Continued)

Additionally, The Organization has made an equity investment in ZFI of \$166,000. This equity investment plus the \$3,857,892 loaned to ZFI comprise the \$4,023,892 budgeted for the purchase, construction and renovation of the Firehouse Property.

On December 17, 2008, ZFI purchased the Firehouse Property from the previous owner. Events occurring at that date are described as having occurred “at closing.”

In connection with the Firehouse Property 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 the Organization | 350,000 |
| Fee paid at completion to the Organization | <u>130,000</u> |
| | <u>\$ 800,000</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 the Organization represents a payment for management of the predevelopment process.

The \$130,000 was due at completion (April 1, 2010) to the Organization and is for the purpose of establishing an operating reserve of \$50,000 and a debt service escrow of \$80,000. This amount was due to the Organization from ZFI as of December 31, 2010 and March 31, 2011 and remained due to the Organization from ZFI as of December 31, 2013 and March 31, 2014.

Contributions

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire (that is, when a stipulated time restriction ends or purpose restriction is accomplished) in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily restricted or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions.

Contributions of long-lived assets (including enhancements to property and equipment) 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. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies (Continued)

Contributions (Continued)

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

Cash and Cash Equivalents

The Organization 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 was \$5,582 and \$5,574 as of March 31, 2014 and 2013, respectively.

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. It is the Organization's policy to capitalize all purchases or contributions of assets with an expected useful life greater than one year that have an initial purchase price or donated value equal to or in excess of \$1,000. 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 as follows:

| | |
|-----------------------------------|--------------|
| Furniture, fixtures and equipment | 5 - 10 years |
| Building | 40 years |
| Building improvements | 30 years |

Notes Receivable

Notes receivable are stated at unpaid principal balances, less unearned discounts. Unearned discounts are recognized as interest income over the term of the loans using the effective interest method.

Deferred Financing Costs

Deferred financing costs associated with the issuance of notes receivable at below-market rates are capitalized and amortized over the lives of the respective notes using the effective interest method. Amortization of deferred financing costs is included in interest expense in the accompanying consolidated statement of activities.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies (Continued)

Deferred Debt Issuance Costs

Deferred debt issuance costs include amounts paid by ZFI in connection with the issuance of long-term mortgage notes payable in December of 2008 to finance the Firehouse Property project, as well as the fair value of contributed legal services directly allocable to the issuance of these notes. Amortization of deferred debt issuance costs is calculated using the straight-line method over the 30-year term of the notes. As of March 31, 2014 and 2013 debt issuance costs are presented net of accumulated amortization of \$40,170 and \$32,136, respectively.

The Organization's policy is to recognize contributed legal services capitalized as deferred debt issuance costs as an increase in temporarily restricted net assets when received. As the contributed deferred 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. Amortization of deferred debt issuance costs is included in interest expense in the accompanying consolidated statement of activities.

Advertising Expenses

The Organization expenses advertising costs as incurred. Advertising expenses amounted to \$3,615 and \$2,362 for the years ended March 31, 2014 and 2013, respectively.

Income Taxes

The Organization and ZFI are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and Massachusetts state income tax under Massachusetts General Law 180. The Organization and ZFI qualify for the charitable contribution deduction under Section 170(b)(1)(A) and have been classified as organizations other than a private foundation under Section 509(a)(2).

Management evaluates all significant tax positions as required by GAAP. As of March 31, 2014 and 2013, management does not believe that it has taken any tax positions that would require the recording of any additional tax liability nor does it believe that there are any unrealized tax benefits that would either increase or decrease within the next twelve months. The Organization's and ZFI's income tax returns generally remain open for examination for three years from the date filed with each taxing jurisdictions.

Fair Value Measurement

GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

2. Summary of Significant Accounting Policies (Continued)

Fair Value Measurement (Continued)

Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

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

3. Contributions Receivable

Contributions 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.

Contributions receivable are due to be collected according to the following schedule as of March 31:

| | <u>2014</u> | <u>2013</u> |
|----------------------------|-------------------|-------------------|
| Less than one year | \$ 140,333 | \$ 174,503 |
| Between one and five years | <u>-</u> | <u>75,000</u> |
| | 140,333 | 249,503 |
| Allowance for bad debts | <u>(2,000)</u> | <u>(2,000)</u> |
| | <u>\$ 138,333</u> | <u>\$ 247,503</u> |

4. Amounts Held in Escrow

Amounts held in escrow of \$130,000 as of March 31, 2014 and 2013 represent funds held by MHIC on behalf of ZFI. These funds at March 31, 2014 and 2013 consist of an \$80,000 debt service escrow and \$50,000 which serves as an operating reserve.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

5. Notes Receivable

The Organization made two sponsor loans, totaling \$1,979,562 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 \$1,587,857 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 ZFI of \$1,587,857 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.

Notes receivable consist of the following as of March 31:

| | 2014 | 2013 |
|--|--------------|--------------|
| 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, the Organization is to receive monthly payment of \$5,293 beginning November 2017 with the balance of the note receivable due at maturity in December 2038. | \$ 1,587,757 | \$ 1,587,757 |
| Tranche B note receivable from MHIC New Markets Fund II with a stated interest rate of 0%. The balance of the note receivable due at maturity in December 2038. | 391,805 | 391,805 |
| | 1,979,562 | 1,979,562 |
| Less unamortized discounts for below-market rate loans: | | |
| Tranche A note receivable from MHIC New Markets Fund II (calculated using imputed interest rate of 5.38%) | (849,463) | (887,143) |
| Tranche B note receivable from MHIC New Markets Fund II (calculated using imputed interest rate of 5.38%) | (284,906) | (290,362) |
| | (1,134,369) | (1,177,505) |
| Notes receivable, net of discount | \$ 845,193 | \$ 802,057 |

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

5. Notes Receivable (Continued)

It is the Organization's intent to use the proceeds received from these notes receivable agreements to repay the mortgage notes payable as described further in Note 8. Accordingly these notes receivable are considered to have been set aside for the repayment of long-term debt.

Interest income for the years ended March 31, 2014 and 2013 include \$43,136 and \$40,935, respectively, which represent the amortization of the original issue discounts on notes receivable.

6. Property and Equipment

Property and equipment consists of the following as of March 31:

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|---------------------|
| Furniture and fixtures | \$ 32,026 | \$ 32,026 |
| Motor vehicle | 22,423 | 22,423 |
| Computer equipment | 260,324 | 211,405 |
| Website | 16,000 | 16,000 |
| Land | 227,998 | 227,998 |
| Building and improvements | <u>3,450,712</u> | <u>3,420,622</u> |
| | 4,009,483 | 3,930,474 |
| Less accumulated depreciation and amortization | <u>(671,397)</u> | <u>(493,752)</u> |
| Property and equipment, net | <u>\$ 3,338,086</u> | <u>\$ 3,436,722</u> |

As of March 31, 2014 and 2013, building and improvements include \$74,265 and \$77,094, net of accumulated amortization of \$10,609 and \$7,780, respectively, of capitalized interest costs incurred during the period of construction.

7. Deferred Financing Costs

Deferred financing costs of \$1,134,369 and \$1,177,505 as of March 31, 2014 and 2013, respectively, net of accumulated amortization of \$201,711 and \$158,575, respectively, represent the asset deemed to have been received by the Organization in exchange for accepting the Tranche A and Tranche B notes receivable at below-market interest rates.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

8. Mortgage Notes Payable

Mortgage notes payable consist of the following as of March 31:

| | 2014 | 2013 |
|---|--------------|--------------|
| 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 \$3,547,047. Monthly payments of \$5,292 due beginning November 2017 through December 2038. | \$ 1,587,757 | \$ 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 \$3,547,047. All principal payable at maturity in December 2038. | 391,805 | 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 \$3,547,047. Payments of interest only in arrears, calculated using the stated 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, balance due at maturity in December 2038. | 824,685 | 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 \$3,547,047. 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 in December 2038. | 133,645 | 133,645 |
| 0% note payable to MHIC New Markets CDE II Series 5, LLC. Secured by a third mortgage and security in land and building, carrying value of \$3,547,047. Payments of \$3,067 due monthly beginning November 2017 through December 2038, balance due at maturity in December 2038. Guaranteed by East Boston CDC. | 920,000 | 920,000 |
| | 3,857,892 | 3,857,892 |
| Discount for imputed interest on below-market interest rate loans | (2,313,249) | (2,398,523) |
| Mortgage notes payable, net | \$ 1,544,643 | \$ 1,459,369 |

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

8. Mortgage Notes Payable (Continued)

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

For the years ended March 31, 2014 and 2013, interest expense included \$85,275 and \$80,052, respectively, related to the amortization of discounts on mortgage notes payable.

Under the terms of each of the respective mortgage note payable agreements, ZFI 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:

| | | |
|------------|----|-------------------------|
| 2015 | \$ | - |
| 2016 | | - |
| 2017 | | - |
| 2018 | | 22,218 |
| 2019 | | 133,308 |
| Thereafter | | <u>3,702,366</u> |
| | \$ | <u><u>3,857,892</u></u> |

9. Deferred Income

In connection with the purchase and renovation of the Firehouse Property, ZFI entered into several long-term financing agreements by issuing mortgage notes payable with face amounts totaling \$3,857,892 as described in Note 8. 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 \$2,656,213 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 ZFI also recognized deferred income in the amount of \$2,656,213 which ZFI will amortize as income over the lives of the notes using the effective interest rate method. Unamortized deferred income amounted to \$2,313,249 and \$2,398,523 as of March 31, 2014 and 2013, respectively.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

10. Temporarily Restricted Net Assets

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

| | <u>2014</u> | <u>2013</u> |
|---|-------------------|-------------------|
| Amounts restricted for use in future periods | \$ 100,000 | \$ 225,000 |
| Contributed debt issuance costs to be amortized in future periods | 88,178 | 91,878 |
| Amounts restricted for program and salary expenditures | 37,875 | - |
| Amounts restricted for purchase of program equipment | 5,258 | 22,985 |
| Amounts restricted for capacity building | - | 7,165 |
| | <u>\$ 231,311</u> | <u>\$ 347,028</u> |

Net assets were released from donor restrictions by incurring expenses or otherwise satisfying the purpose restrictions specified by donors as follows during the years ended March 31:

| | <u>2014</u> | <u>2013</u> |
|---|-------------------|-------------------|
| Expiration of donor-imposed time restrictions: | \$ 150,000 | \$ 225,000 |
| Purpose restrictions accomplished: | | |
| Capital project related | 17,727 | 14,462 |
| Amortization of contributed debt issuance costs | 3,700 | 3,700 |
| Capacity building activities | 7,165 | 52,835 |
| | <u>28,592</u> | <u>70,997</u> |
| Net assets released from restrictions | <u>\$ 178,592</u> | <u>\$ 295,997</u> |

11. Operating Reserve and Capitalization

Historically, ZUMIX has maintained a stable financial position by achieving reasonable, modest end-of-year surpluses. With the increased responsibility of facilities ownership, ZUMIX has increased its commitment to financial stability by: 1) contributing to the capital asset replacement reserve an amount equal to budgeted depreciation each year, and 2) working to maintain three months of unrestricted operating reserves at all times.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

11. Operating Reserve and Capitalization (Continued)

Months of unrestricted operating funds held by the Organization on March 31, 2014 was calculated as follows:

| | |
|---|-------------------|
| Cash balance | \$ 547,304 |
| Temporarily restricted net assets with purpose restrictions | (43,133) |
| Management designated capital asset replacement reserve | (224,755) |
| Cash balance less restricted and designated funds | <u>\$ 279,416</u> |
| | |
| Average monthly operating expenses | \$ 92,495 |
| Months of unrestricted operating funds | 3.02 |

12. Credit Card Line of Credit

The Organization has a business line of credit available from a credit card company allowing for purchases or cash borrowings. As of March 31, 2014, the Organization had no outstanding cash borrowings and had an outstanding balance from purchases of \$7,850 which is included in accounts payable and accrued expenses. As of March 31, 2014, the Organization has remaining credit available for purchases of \$24,850 and \$11,200 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, as of March 31, 2014.

As of March 31, 2013, the Organization had no outstanding cash borrowings and had an outstanding balance from purchases of \$4,534 which is included in accounts payable and accrued expenses. As of March 31, 2013, the Organization has remaining credit available for purchases of \$28,166 and \$11,200 for cash advances.

13. Interest

For the year ended March 31, 2014 and 2013, total interest expense amounted to \$142,684 and \$135,251, respectively. No interest was capitalized during the year ended March 31, 2014 and 2013. Amortization of deferred financing and debt issuance costs included in interest expense amounted to \$51,170 and \$48,968, respectively.

14. Concentrations of Credit Risk

Financial instruments which subject the Organization to credit risk consist principally of temporary cash investments, amounts held in escrow and notes receivable. Temporary cash investments may at times exceed amounts insured by the FDIC. As of January 1, 2013 the FDIC provides insurance of up to \$250,000 per depositor, per insured bank. The Organization places its temporary cash investments with high quality financial institutions. At March 31, 2014 balances in cash and temporary cash investment accounts exceeded the amount insured by the FDIC by \$315,970. As of March 31, 2014, the Organization's funds in excess of FDIC limits are deposited with a Massachusetts-chartered savings bank which is a member of the Depositors Insurance Funds (DIF). The DIF insures all amounts in excess of FDIC insured limits deposited with member banks. Notes receivable are due to the Organization from a single borrower as described in Note 5. The Organization does not require collateral or other security to support notes receivable or other financial instruments subject to credit risk.

ZUMIX, INC. AND AFFILIATE

Notes to Consolidated Financial Statements

March 31, 2014 and 2013

15. Retirement Plan

During the year ended March 31, 2012 the Organization began sponsoring a defined contribution retirement plan for eligible employees. Annual contributions are at the discretion of the Organization. During the years ended March 31, 2014 and 2013, the Organization made contributions to the plan amounting to \$4,902 and \$4,392 which amounted to 1% of the gross salary of eligible employees for each of the fiscal years then-ended.

16. Reclassification

Certain amounts included in the consolidated financial statements for the year ended March 31, 2013 have been reclassified to conform to the current year presentation. These reclassifications had no impact on previously reported consolidated net assets or changes in consolidated net assets.

17. Subsequent Events

The Organization has evaluated subsequent events through October 30, 2014, the date the financial statements were available to be issued.

ZUMIX, INC. AND AFFILIATE

Consolidating Statement of Financial Position

(Supplementary Information)

March 31, 2014

| | ZUMIX, Inc. | ZUMIX Firehouse, Inc. | Elimination | Consolidated |
|---|---------------------|----------------------------------|---------------------|---------------------|
| <i>Assets</i> | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 547,304 | \$ 29,697 | \$ - | \$ 577,001 |
| Amounts held for others | 15,403 | - | - | 15,403 |
| Contributions receivable, net | 138,333 | - | - | 138,333 |
| Prepaid expenses and other current assets | 29,434 | - | - | 29,434 |
| Total current assets | <u>730,474</u> | <u>29,697</u> | <u>-</u> | <u>760,171</u> |
| Amounts held in escrow | - | 130,000 | - | 130,000 |
| Due from affiliate | 130,000 | 23,100 | (153,100) | - |
| Property and equipment, net | 208,283 | 3,555,053 | (425,250) | 3,338,086 |
| Notes receivable, net | 845,193 | - | - | 845,193 |
| Deferred debt issuance costs, net | - | 200,842 | - | 200,842 |
| Deferred financing costs, net | 1,134,369 | - | - | 1,134,369 |
| Interest in the net assets of ZUMIX Firehouse, Inc. | 166,000 | - | (166,000) | - |
| Total assets | <u>\$ 3,214,319</u> | <u>\$ 3,938,692</u> | <u>\$ (744,350)</u> | <u>\$ 6,408,661</u> |
| <i>Liabilities and Net Assets</i> | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued expenses | \$ 72,165 | \$ 528 | \$ - | \$ 72,693 |
| Amounts held for others | 15,403 | - | - | 15,403 |
| Total current liabilities | <u>87,568</u> | <u>528</u> | <u>-</u> | <u>88,096</u> |
| Due to affiliate | 23,100 | 130,000 | (153,100) | - |
| Deferred income | - | 2,313,249 | - | 2,313,249 |
| Mortgage notes payable, net | - | 1,544,643 | - | 1,544,643 |
| Total liabilities | <u>110,668</u> | <u>3,988,420</u> | <u>(153,100)</u> | <u>3,945,988</u> |
| Net assets: | | | | |
| Unrestricted | 2,960,518 | (137,906) | (591,250) | 2,231,362 |
| Temporarily restricted | 143,133 | 88,178 | - | 231,311 |
| Total net assets | <u>3,103,651</u> | <u>(49,728)</u> | <u>(591,250)</u> | <u>2,462,673</u> |
| Total liabilities and net assets | <u>\$ 3,214,319</u> | <u>\$ 3,938,692</u> | <u>\$ (744,350)</u> | <u>\$ 6,408,661</u> |

See accompanying independent auditors' report

ZUMIX, INC. AND AFFILIATE

Consolidating Statement of Activities and Changes in Net Assets

(Supplementary Information)

For the Year Ended March 31, 2014

| | ZUMIX, Inc. | | | ZUMIX Firehouse, Inc. | | | Elimination | Consolidated |
|--|---------------------|---------------------------|---------------------|-----------------------|---------------------------|--------------------|---------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Total | Unrestricted | Temporarily Restricted | Total | | |
| Support and revenue: | | | | | | | | |
| Individual donations | \$ 71,110 | \$ - | \$ 71,110 | \$ - | \$ - | \$ - | \$ - | \$ 71,110 |
| In-kind donations | 27,685 | - | 27,685 | - | - | - | - | 27,685 |
| Corporate donations | 26,709 | - | 26,709 | - | - | - | - | 26,709 |
| Foundation donations | 415,791 | 62,875 | 478,666 | - | - | - | - | 478,666 |
| Events | 43,696 | - | 43,696 | - | - | - | - | 43,696 |
| Government grants | 44,994 | - | 44,994 | - | - | - | - | 44,994 |
| Program fees | 145,704 | - | 145,704 | - | - | - | - | 145,704 |
| Interest income | 48,390 | - | 48,390 | 25 | - | 25 | - | 48,415 |
| Amortization of deferred income from below-market interest rate loans | - | - | - | 85,275 | - | 85,275 | - | 85,275 |
| Rental income | 25,950 | - | 25,950 | 11,193 | - | 11,193 | (11,193) | 25,950 |
| Sale of product | 2,811 | - | 2,811 | - | - | - | - | 2,811 |
| Net assets released from restriction | 174,892 | (174,892) | - | 3,700 | (3,700) | - | - | - |
| Total support and revenue | 1,027,732 | (112,017) | 915,715 | 100,193 | (3,700) | 96,493 | (11,193) | 1,001,015 |
| Expenses: | | | | | | | | |
| Youth programs | 823,411 | - | 823,411 | 207,310 | - | 207,310 | (24,370) | 1,006,351 |
| Community arts program | 101,561 | - | 101,561 | - | - | - | - | 101,561 |
| Total program expenses | 924,972 | - | 924,972 | 207,310 | - | 207,310 | (24,370) | 1,107,912 |
| Management and general | 153,346 | - | 153,346 | 11,567 | - | 11,567 | (1,511) | 163,402 |
| Fundraising | 80,818 | - | 80,818 | 11,517 | - | 11,517 | (1,511) | 90,824 |
| Total expenses | 1,159,136 | - | 1,159,136 | 230,394 | - | 230,394 | (27,392) | 1,362,138 |
| Increase (decrease) in net assets | (131,404) | (112,017) | (243,421) | (130,201) | (3,700) | (133,901) | 16,199 | (361,123) |
| Net assets, beginning of year | 3,091,922 | 255,150 | 3,347,072 | (7,705) | 91,878 | 84,173 | (607,449) | 2,823,796 |
| Net assets, end of year | <u>\$ 2,960,518</u> | <u>\$ 143,133</u> | <u>\$ 3,103,651</u> | <u>\$ (137,906)</u> | <u>\$ 88,178</u> | <u>\$ (49,728)</u> | <u>\$ (591,250)</u> | <u>\$ 2,462,673</u> |

See accompanying independent auditors' report

ZUMIX, INC. AND AFFILIATE

Consolidating Statement of Cash Flows

(Supplementary Information)

For the Year Ended March 31, 2014

| | ZUMIX | | | |
|--|--------------------|------------------------|--------------------|---------------------|
| | ZUMIX, Inc. | Firehouse, Inc. | Elimination | Consolidated |
| Cash flows from operating activities: | | | | |
| Decrease in net assets | \$ (243,421) | \$ (133,901) | \$ 16,199 | \$ (361,123) |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: | | | | |
| Amortization of deferred financing and debt issuance costs | 43,136 | 8,034 | - | 51,170 |
| Amortization of discount on notes receivable | (43,136) | - | - | (43,136) |
| Amortization of deferred income | - | (85,275) | - | (85,275) |
| Amortization of discount on mortgage notes payable | - | 85,275 | - | 85,275 |
| Depreciation | 62,882 | 130,822 | (16,199) | 177,505 |
| Contributed property and equipment | (10,231) | - | - | (10,231) |
| Changes in operating assets and liabilities: | | | | |
| Decrease in contributions receivable | 109,170 | - | - | 109,170 |
| Increase in prepaid expenses | (13,297) | - | - | (13,297) |
| Increase in accounts payable and accrued expenses | 28,345 | - | - | 28,345 |
| Net cash provided by (used in) operating activities | <u>(66,552)</u> | <u>4,955</u> | <u>-</u> | <u>(61,597)</u> |
| Cash flows from investing activities: | | | | |
| Purchases of property and equipment | <u>(16,155)</u> | <u>-</u> | <u>-</u> | <u>(16,155)</u> |
| Net cash used in investing activities | <u>(16,155)</u> | <u>-</u> | <u>-</u> | <u>(16,155)</u> |
| Net increase (decrease) in cash and cash equivalents | (82,707) | 4,955 | | (77,752) |
| Cash and cash equivalents, beginning of year | <u>630,011</u> | <u>24,742</u> | <u>-</u> | <u>654,753</u> |
| Cash and cash equivalents, end of year | <u>\$ 547,304</u> | <u>\$ 29,697</u> | <u>\$ -</u> | <u>\$ 577,001</u> |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | | | |
| Contributions of equipment | \$ 10,231 | \$ - | \$ - | \$ 10,231 |
| Contributions of supplies and items for sale | <u>17,454</u> | <u>-</u> | <u>-</u> | <u>17,454</u> |
| | <u>\$ 27,685</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 27,685</u> |
| Cash paid for interest | <u>\$ -</u> | <u>\$ 4,574</u> | <u>\$ -</u> | <u>\$ 4,574</u> |