Strategic Philanthropy Advisors

Assessment of the Current Organizational Capacity Of the Mexican Heritage Corporation With Recommendations for Improvements

Submitted to The City of San Jose and the San Jose Redevelopment Agency

> Submitted by Strategic Philanthropy Advisors, LLC February 15, 2008



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Introduction

The purpose of this report is to provide a financial feasibility and operational assessment of the Mexican Heritage Corporation ("MHC") for the City of San Jose. Much has changed since Strategic Philanthropy Advisors, LLC was commissioned by the City in partnership with the San Jose Redevelopment Agency on this project. Currently MHC has a severe liquidity problem that could potentially lead to insolvency. On January 9, 2008, the organization made a formal request to the City that it's annual Operations and Maintenance subsidy of \$413,783 — provided to it as operator of the Mexican Heritage Plaza ("Plaza") — be increased by \$300,000 for this fiscal year. City Council will consider the request at its March 18, 2008 meeting.

Dr. Maribel Alvarez and Tom Borrup, the consultants assessing the viability of the Plaza's existing operating model in terms of programs, vision, best practices and community buy-in, have presented their report to the City. They provided four options for alternative uses for the Plaza and recommended "the adoption of an entirely new or substantially re-tooled organizational operating model by a Plaza operator." It was outside of Alvarez and Borrup's scope of work to determine whether the existing MHC organization had the willingness or capacity to adopt their recommended Best Practices for a new operational model. They noted, however, that they believed their recommendations for retooling implied "profound changes in the nature, vision, and management practices" of any Plaza operator. They also presented an option that "addresses some of the community's interest" yet requires a transition arrangement with the City taking over the operations and maintenance of the facility while reviewing and deciding next steps.

Strategic Philanthropy Advisors, LLC submitted a report on our analysis of the Operations and Maintenance Agreement ("O&M Agreement") between the City of San Jose and MHC, which included our calculation as to how much it has cost to operate and maintain the Plaza over the last five years. (Appendix 2)

We determined that the City-paid annual operations and maintenance subsidy was more than adequate to cover the operations- and maintenance-related costs for the facility in light of the O&M Agreement entered into by the City and MHC, which stated that "City's funding assistance...*is intended to supplement* MHC's other funding sources", which we interpreted to mean that under the contract terms, the City's annual O&M subsidy was never meant to cover 100 percent of the costs associated with operating and maintaining the Plaza. We concluded that while the agreement never reference staff costs, the subsidy in fact did not include enough money to pay for all of the basic staff costs that we felt was needed to operate the facility. We provided the City with several scenarios for consideration depending on its desire to potentially amend the agreement.

Scenario 1 is the current status quo while Scenario 2 suggested the subsidy be increased to pay for Basic Staff costs (approximately \$200,000) plus an average of the actual operations and maintenance costs for the past five years (approximately \$294,000) for an approximate subsidy of \$511,000. Obviously the City and MHC would need to review the historical costs to maintain the Plaza in light of any changes recently made to the facility through the \$1,000,000 State of California grant made to MHC for capital improvements to the Plaza.



Scenario 3 suggested that if the City wanted to increase the annual subsidy to MHC for operating and maintain the Plaza, it might want to take into account the cost to run the facility that included a percentage of the staff costs required to keep it operational, raise funding for it, pay its bills, and market it to the community. This scenario acknowledges that the facility does not run itself and there are staff that have a responsibility for it outside of the direct facility and operational maintenance staff. This scenario gives consideration to an amount that would cover the costs to maintain the facility (Basic Staff) and a percentage of MHC's indirect cost that would include a percentage of the staff salaries and benefits for many of the positions that MHC asked the City to cover 100 percent. These positions are related to administration, fundraising, finance, and marketing. This would be following Best Practices as to how nonprofit organizations allocate indirect expenses to programs and in our opinion, the Plaza is a program. It also means that MHC would allocate a percentage of these same expenses to all of its programs – not just to the Plaza's budget.

Unfortunately, as we noted in our report, we were not able to determine how much time all of these staff members spend on all of MHC's various programs but we thought that a sum of between 15 to 35 percent of indirect costs was reasonable based on industry standards. This could potentially increase the current annual O&M subsidy to approximately \$548,000 or even more. In our opinion, this made more sense than MHC's request to the City for coverage of 100 percent of these referenced positions as MHC has programs other than the Plaza that require administrative, fundraising, marketing, and financial oversight. This report (Appendix 2: Pages 78) also summarized MHC's financial requests.

Presently many different scenarios are being considered by the City and by MHC based on the two consultant reports, community feedback, and financial considerations for both entities as it relates to the Plaza, vision and offerings of programs, operating models, financial sustainability, and the community. As one would expect, the related financial, operating and programmatic considerations vary greatly as are the ideas for a solution that would be beneficial to all interested parties. As we draft this report, we do not know what the outcome will be.

Our project scope is to assess MHC's current financial and organizational capacity and provide recommendations as to how the organization can strengthen its operational capacity. We have not addressed the organization's departments or programs as this was covered extensively in the Plaza Consultant's report. We have been asked by the City instead to focus on MHC's current financial statements and operating capacity outside of its current program offerings. We have also been asked to concentrate on the present situation and not focus on the past so we have not evaluated or included an assessment of the Wolf Report prepared by the Wolf Organization (May 1995) and the Resident Art Partners Agreement (July 2001) as the former report is now dated and related to the latter, there are differing opinions amongst all parties as to whether or not there is a current agreement in place and what will be the status of the partnership in the future. We note, however, that in many public documents MHC believes that its current capacity issue is due to its perceived structural deficit.

We are making an assumption that the reader of this report is familiar with the City Auditor's report (March 2007), the Plaza Consultant's report (Alvarez and Borrup January 2008) and MHC's responses to these reports as well as letters it has sent to the City Manager over the last several years



related to the financial relationship between the City and MHC. We have been asked not to provide a historical context for our assessment. We note that there are many differing opinions and interpretations on the history between MHC, the Plaza and the City and whether or not the current operating model for the Plaza has been and is currently appropriate.

In our opinion, our findings and recommendations are appropriate regardless of whether or not MHC remains as operator and programmer of the Plaza, remains at the Plaza as a Resident Art Partner, or leaves the facility and establishes itself in an office downtown and focuses solely on the Mariachi Festival and Mariachi Youth Education.

We note that the format for our report is not conventional for we have not simply presented our findings to our client as most assessments do but we have also provided our recommendations to the organization that is the focus of the study in the hope that they will be helpful to it. As such, we only present our findings that, in our opinion, could help the nonprofit strengthen its capacity if addressed.

Executive Summary

Questions of "capacity" are more than just fashionable, jargon-infused nonprofit talk. Capacity means leadership, management, technical ability and the ability to adapt to changing circumstances. This much we know: organizations grow capacity over time; excellent organizations are those that are able to match aspirations to capacity in concrete, demonstrable terms; and third, capacity refers to the internal dynamics/practices/assessments that an organization makes in relation to external factors outside its control (in other words, capacity is what allows an organization to calibrate shifts in funding, to take calculated risks that pay off, and to deepen its overall position of esteem among community members.)

Clearly an organization that is set to run out of cash before the end of its fiscal year — with a projected deficit of \$300,000 unless it receives additional funding — has financial and organizational capacity issues. This is not a one time occurrence as this is the second year in a row that MHC has requested emergency funding from the City of San Jose.

The question we set out to answer for the City is whether or not MHC's precarious financial situation is a pure cash flow issue — the result of the timing between cash inflows and cash outflows — or is structural in nature related to their business and operational practices. Our assessment has determined that across the last five years, it has been a bit of both. There is a substantive difference, however, between each kind of problem. Cash flow problems can be addressed by standard financial tools such as lines of credit or internal reserves; the key difference however is that cash flow problems presumes that receivables are forthcoming, just not in time, while problems involving structural business and operational practices represent a more serious and potentially devastating challenge that goes to the core of sustainability.

At the current juncture we find that what may have started as a cash flow problem years ago for MHC (and we do not know when) has in our opinion, become primarily a structural management and financial practices situation; as such, the implications are more severe.

Assessment Methodology and Philosophy

Our report to the City presents key findings based on our assessment of documents provided to us by MHC and offers related recommendations for MHC to strengthen its organizational capacity. We did our best to request all documents that we felt would help us make our assessment and we relied on MHC to send us any documents that it felt we had not asked for but knew existed and would be helpful or important for to review. We are not auditors and the Office of the City Auditor has already presented its own review of MHC's ability to operate and maintain the Plaza. (March 2007) Our charge is to provide a current assessment of the organization and make recommendations that MHC can use to improve its own performance as an organization. This report contains our assessment and our opinions that were made in good faith. Strategic Philanthropy Advisors, LLC is not a law firm; there are no attorneys on the consulting team, nor any accountants.

Any time a consultant is hired to conduct a financial and operational assessment for a nonprofit organization where the invitation does not come from the organization itself; there is a possibility that the report will be interpreted differently by the client and by the organization. In this



assessment our client is the City and not MHC. Our report is presented to the City and not MHC even though our recommendations are obviously for the organization to take under advisement and act upon them if it agrees with them.

Many entities, be they for-profit or non-profit, constantly evaluate their management practices and financial capacity and look for ways to strengthen itself as well as how it is perceived, correctly or incorrectly, in the public eye. It is in this context that we present our findings and recommendations.

All along in this very complicated context that MHC's dilemmas' have unfolded, we have always understood that there were many departure points. We want to make absolutely clear that the standards of nonprofit best practices are ones that we used to assess MHC's capacity and it is these standards that form the basis for our recommendations. They are not accounting standards, or legal standards, or policy standards, or political standards, or ones that are concerned with the minutia of clarification. Instead they are based on general philanthropic standards that, in our opinion, many private funders would use to evaluate a nonprofit when considering whether or not to make a large investment in an organization. These are the standards where Strategic Philanthropy Advisors, LLC has plenty of expertise. The five partners have collectively more than 100 years of grant making experience and nonprofit assessment. We formed our firm after more than a decade of jointly managing corporate social responsibility and philanthropic programs at a major international financial institution, making grants totaling more than \$70 million each year.

Our purpose in presenting this report, at the request of the City, is to ultimately help MHC. We are a true outsider to both San Jose and the organization itself. We have no bias to cloud our judgment. We have no point of view regarding the Plaza and how it should be operated in the future and by whom. We have no say in the current or future allocation of City resources to MHC or in how the City Manager's Office is evaluating MHC's current financial requests.

Our findings have been shaped through numerous meetings, phone calls, and emails with MHC; interviews with members of the community and the various City departments that have worked with the organization, as well as a review of numerous documents. We understand, however, that when an organization, especially one that has had to face many challenges and feels that it has overcome many obstacles and is on a better path today then it was three years ago, are presented with findings from an outsider, such interpretations of its current capacity will not always be warmly greeted. Performance assessment requires that feedback be given and it is not always painless. We realize that the sum of all of our findings is ambiguous but we are illuminating what we have seen. In no way should our findings and recommendations *in any way* be interpreted as being disparaging to the CEO and Board (past or present) of MHC or even to the City. No attempt has been made to create outright and deliberate falsehoods with any of our findings.

In addition, it is our opinion, that our recommendations are applicable whatever course of action the organization identifies moving forward. Among several options that have been raised in the last few months are the organization remains at the Plaza as operator and programmer, remains at the Plaza as a resident art partner and programmer, leaves the Plaza and moves downtown to run the Mariachi Festival and Mariachi youth education programs, or remains at the Plaza and opens the Cesar



Chavez math and music center in partnership with local institutions of higher learning or, operates another model all together.

Overview

There are a great number of issues – financial and operational – that MHC needs to address before it can be stated unequivocally that it has acquired the "capacity" to thrive. In terms of its immediate liquidity crisis, the Board of Directors has to develop a plan to solve MHC's cash flow issues in the event that the City does not provide the requested additional subsidy payments this fiscal year. This will require MHC to make difficult choices related to staffing and corporate assets and to find new revenue sources (individual donors, foundations, corporate sponsors) or financing options. It needs to review all expenses and potentially make drastic cuts in all areas including staff. In our opinion, this should have occurred as soon as MHC realized that income generated from the Mariachi Festival was \$211,000 less than budgeted and no income had yet been generated from four budget line items totaling \$190,000 for a total budgeted income shortfall of \$401,000 by the end of November 2007 before expenses. *Note: All of the financial information that we analyzed was to December 31, 2007. MHC could have received additional income and conversely cut expenses between the date of this report and the end of December.*

Key Findings:

- 1. Inconsistent financial data has been presented to internal and external audiences.
- 2. The organization does not prepare a realistic and conservative income-based budget. Several revenue line items were added without realistic assumptions made by MHC as to whether the projected income was achievable. As of December, 31, 2007 no revenue had been generated from these four categories totaling \$190,000.
- 3. The 2007 Mariachi Festival was projected to net \$300,000 cash for the organization and instead made \$71,941, causing a budget shortfall of \$211,259.
- 4. Staff costs have grown 76 percent or \$426,267 from FYE2006 to those budgeted for FYE2008.
- 5. Cash flow forecasts presented to us were not properly prepared and did not go beyond the end of the fiscal year making it difficult to inform the reader of current and future cash flow projections.
- 6. Revenue and expense categories are not consistently used in all financial documents, making comparisons hard.
- 7. MHC does not prepare a proper line-item budget for the organization, making it difficult for the Board and the City to read at a glance how the organization is doing financially. Instead it has two budgets: one for Mariachi Festival and another "organizational" budget that includes the "net" income from all of the components of the Mariachi Festival.
- 8. MHC's income is not diversified and relies heavily on the City for general operating financial support.
- 9. Individual contributions and grants from foundations are very low and most of the corporate support is derived from the sponsorship of the Mariachi Festival and not from direct contributions.
- 10. MHC is out of compliance with the terms of its loan and O&M agreements with the City.
- 11. Financial policies and control measures need to be reviewed annually by the Board of Directors as well as those required by law.



12. The organization has made a good first attempt at program budgeting for the 2008-2009 fiscal year but is not yet following best practices for indirect cost allocations.

Selected Recommendations for MHC:

- ✓ Take corrective action to reduce costs in response to unfavorable financial results from the Mariachi Festival and other line items that have not generated any revenue to date. We understand the organization might have already cut costs but it is still forecasting a \$300,000 deficit that needs to be addressed.
- ✓ Prepare a straightforward and auditable financial report on the current condition of MHC.
- ✓ Prepare proper cash flow forecast statements that look 18 months ahead on a rolling basis so that appropriate corrective action can be taken immediately when cash inflows are less than cash outflows.
- ✓ Create a realistic and balanced line-item budget for the balance of this fiscal year and for the next two years with staff and other costs at a sustainable level. Do not include "nets" from program budgets.
- ✓ Generate all financial statements from the accounting system using the general ledger accounts titles created by MHC. We also recommend that the Finance Committee, senior and program staff review these titles to determine if the current categories make the most sense relative to the amount of detailed information that should be captured to effectively evaluate its financial situation.
- ✓ Budgeting exercises should include worksheets that identify the source and types of projected income by name.
- ✓ Create budgets that include the dollar change between the current year's actual results for the review period against last year's actual results so the reader can determine how MHC's current revenue and expenses categories are performing compared to the historical data.
- ✓ If MHC wants to include in-kind and donated products and services in its cash program budgets it must include a revenue line item as well as an expense line item that nets to zero.
- ✓ All financial spreadsheets and data presented or shared with internal and external audiences need to be dated so that all parties can be certain that they are reviewing the most recent information.
- ✓ The Board of Directors needs to continue to be active in all aspects of fund development and fund raising. The organization needs to have a well researched and developed fund raising plan put in place so that it can court new individual donors, and equally needs to look at fundraising opportunities within its own Board of Directors.
- ✓ Review all legal obligations and correct any areas where it is out of compliance.
- \checkmark The Board needs to review all internal policies and controls and add to them if necessary.
- ✓ The Board must decide what is best for MHC's core programs and identity and its relationship to the Plaza. Then it needs to create a new document that will articulate its mission, values, goals and strategizes how it will serve the community (however it chooses to define it) with programming that has impact.

Our findings are not to negate the challenges that the organization has encountered over the last several years or to devalue the efforts of the current CEO and Board of Trustees. The purpose of our report is to provide an analysis of MHC's current financial and operating capacity to our client, the City of San Jose. We hope that MHC will embrace our findings and recommendations.



Financial and Operational Assessment: Findings and Recommendations

This section is organized by topic. Our findings are listed in bullet point followed by our recommendations to MHC that we feel would help it address the issues that we observed so that it could strengthen its financial and operating capacity. We caution that the organization is having severe liquidity problems and many of our suggestions will take time to implement. We offer no quick band-aid.

Financial Data and Revenue/Expense Categories

The following examples are good illustrations of how difficult it has been for the consultants to determine MHC's true financial picture using data supplied by the organization as recently as February 2008.

This is not about Generally Accepted Accounting Principles (GAAP) but how the information is interpreted by a lay person. We are not focusing on one single practice because even GAAP lends itself to ambiguity. Organizations can and do have variable budgets and financial statements but combined all of the examples below point to an obfuscating picture not an illuminating one.

<u>Example 1</u>: Over the course of the project and as recently as this month, we have been given four documents that provide the "actual" revenues and expenses for July 2007, the first month of the FYE2008 fiscal year. We were not certain which of these documents showed the correct total for revenues and expenses for the month and how much the organization was over budget. The answer has important implications as the difference between the lowest and highest amount of the budget shortfall for the month is \$29,265. Informed decisions are difficult to make unless comprehensive, accurate and up-to-date data is available and all stakeholders are reviewing the same information.

We realize all nonprofit organizations need to consistently update their spreadsheets in order to reflect actual revenue and expenses; however, they need to be careful that when they do this, the documents are dated and assumptions/changes are noted in a footnote. This way a reader can understand why the numbers might have changed and all parties know that only the most current data/documents are being evaluated.

As an example, the first three documents (July Budget vs. Actual 2007) we received from MHC in electronic and paper forms came from the same Excel spreadsheet. The paper version reference the month but not the date that it was created and the two other documents in electronic forms clearly had adjustments made to it after the organization accrued income or expenses. Unfortunately the changes were made in the August budget prior month actual but the changes were not made to the previous versions. We do not understand the difference between these documents and the Projected Budget Outlook, which was prepared recently and uses actual numbers as well.

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| July 2007 Budget versus Actuals From 4 Different Documents | | | | | | |
|--|--------------|-------------|-------------|------------|--|--|
| | | | | Projected | | |
| | | | Sheet 3 | Budget | | |
| | Sheet 1 | | (August | Outlook | | |
| | Paper | | Budget | 7/07 to | | |
| | Version | Sheet 2 | using Prior | 6/08 | | |
| | Given to | (Electronic | Month's | Actuals to | | |
| | Consultants* | Version) | Actuals) | Date* | | |
| Total Revenue | | | | | | |
| (Year-to-Date) | \$105,579 | \$80,579 | \$80,579 | \$88,857 | | |
| Total Expenses | | | | | | |
| (Year-to-Date) | \$156,840 | \$115,346 | \$144,611 | \$139,019 | | |
| Over/Under | | | | | | |
| Budget | | | | | | |
| (Year-to-Date) | (\$51,261) | (\$34,767) | (\$64,032) | (\$50,161) | | |

* Includes \$25,000 Net Mariachi

** Includes Mariachi (income plus expenses - not net)

<u>Example 2</u>: MHC should not produce financial data that uses inconsistent revenue and expense categories in documents it presents internally and externally. It is challenging for a reader when a new spreadsheet doesn't address a category listed in a prior document. The reader doesn't understand what happened; was the category dropped, reduced to zero or merged within another category? The \$300,000 budget presented to the City detailing how the emergency grant will be spent is a great example of this issue.

| FYE2008 Budget Expense Categories | \$300,000 Emergency Funding Proposed Budget Expense Categories | Projected Budget Outlook July 2007 to June 2008 Expense Categories |
|--------------------------------------|---|--|
| Personnel Costs | Personnel Costs | Personnel Cost |
| Professional Fees | Professional Fees | Office Administration |
| Artist Fees | Website Maintenance | Facility Rental Operation |
| Office Operating Expenses | Utilities | Utilities/PGE/Water/Telephone |
| Communications | Training | Facilities Maintenance |
| Material Costs | Equipment Lease | Programs |
| Production Costs | | Development/Marketing |
| Marketing & Advertising | | MHC (Mariachi Festival) |
| Fundraising Costs | | |
| Occupancy Expense | | |
| Travel/Conference Training | | |
| Equipment | | |
| Business Fees/Miscellaneous | | |

When it is compared to the original budget many questions are raised because the categories are so different. It is natural for a reader to ask what happened to previous categories and why some of these expenses items were not included. It would have been more beneficial if MHC had used the same expense categories for all three documents and presented the City with a budget that referenced all of its expected income and expenses for the remainder of this fiscal year along with notations as to what funds (other than those requested from the City) would be earmarked to cover which costs.



<u>Example 3:</u> The 2007 Mariachi Festival Budget contained extensive expense categories as well as specific revenue line items that specifically projected how much income would be derived from booths for vendors, businesses, and food and the price for each category. The actual revenue and expense statement post event provided to the City and the Consultants condensed or combined many of these categories. As a result it was difficult to see where the projections had been on or off target. Documents should be able to stand alone and not require oral explanations.

Recommendations:

1. All financial statements should be generated from the general ledger accounts using the same line item categories. We understand that many of the categories have been renamed and we suggest that the Finance Committee and Senior and Program staff review all of them to make sure that everyone agrees on the best titles for the organization to use.

It might be appropriate to create header categories and then within these categories create separate line items for all of its related/logical components. The benefit to such a system is that any reader of the organization's financial statements can have a clear understanding of the entity's financial position.

2. MHC should date all financial statements so that there is no confusion as to when they were created. We understand that new invoices or grant amounts might cause statements to be updated, however, from our experience; there is no way to know when a statement was created and which document is the most current.

Budgeting Practices

The annual budget is the guiding financial document of a nonprofit and a measure of its organizational health.

Line Item Budgets

Organizational budgets set the guidelines and priorities for the nonprofit. It also establishes goals for it to achieve related to funding and earned income as expenses must be equal to or less than the total revenues for the year if the organization is going to have a balanced budget.

It is extremely important to track actual revenue and expenses by line items as the year progresses so that the Board and CEO can easily read at a glance how the organization is doing financially. It then allows them to make any corrections to the expense side of the equation if projected income is less than anticipated at any time. A best practice is for an organization to also create program budgets (Appendix 2: Pages75-76), which will be discussed in greater detail later in the report. This document is also reviewed with the organizational budget and also with a cash flow forecast statement, which will also be discussed later in this report.

If an organization maintains separate budgets for some of its programs that it nets into the revenue side of the organizational budget — as MHC does with the Mariachi Festival budget (concerts, gala, workshops, and teacher conference) — the organization does not know how diverse its earned and contributed income sources are by looking at the Revenue and Expense Statements by month or year-to-date. It has no way of knowing whether the program income categories met, exceeded, or



fell below projections. The same is true for the expense side of the budget. In addition, it is not able to compare the current period's actual revenue with the income for the same period in the prior year, which is another best practice.

The two charts below show MHC's FYE2008 budget for revenues versus year-to-date actuals as of December 31, 2007, with percentages of revenue categories. The budget is based on documents that list total revenues/expenses of \$1,777,046.

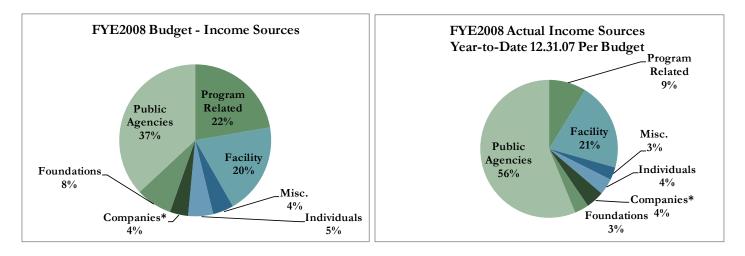


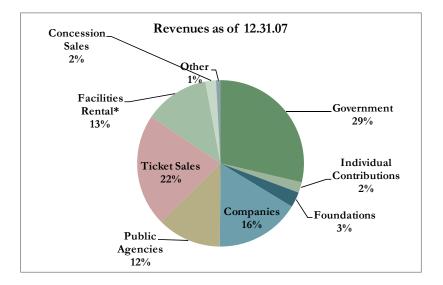
Chart Note: Companies reference corporate support for programs other than Mariachi Festival-related.

The actual revenue numbers in the organizational budget do not break out the ticket sales for the Mariachi festival nor show the amount of corporate sponsorships and grants that support this program. The original Mariachi Festival budget had total revenue projections of \$865,500 and total expenses of \$582,300. A net "Mariachi Ticket Sales" of \$300,000 was listed in the MHC organizational FYE2008 budget under Program Related along with Arts Education Fee for Service of \$50,000 and RAP Rental Income for Office and Theater use of \$30,000.

The chart to the right highlights the lack of diversified income sources as more than half of the revenue for the first six months of the year came from public agencies while the next largest income generator was Plaza facility rentals.

We tried to combine this fiscal year's annual budget with the Mariachi Festival Budget but unfortunately we were not able to break out all of the income categories since some of them were combined in the festival budget. We were able to chart the FYE2008 year-to-date December 31, 2007 total revenues for corporate support, foundations, ticket sales, rental income, government grants and contracts and other categories based on the profit and loss statement generated from the general ledger account. The results are in the following chart:

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Viewing these numbers the corporate sponsorship support for Mariachi is apparent. The fundraising department's own presentation to the Board of Directors on nationwide percentage of philanthropic support notes that the "norm" for support to nonprofit support from companies is only 5 percent. If the Board and external audiences such as the City and foundations are only presented with the \$1,776,046 budget, it appears that year-to-date only 4% of MHC's support comes from corporations yet the true numbers, as evidenced from the Statement of Revenues and Expenditures from the general ledger, shows a much greater level of support: 16 percent.

Recommendations:

- 1. MHC needs to create a true line-item budget for the organization. Mariachi Festival and/or any other program revenue and expense should not net into the organizational budget. We advise the organization to create program budgets; however, there should be one principal budget for the organization.
- 2. MHC needs to review budgets that include the dollar change between the prior year's actual results against its current budget projections. This should be done in two documents: one for the current month and one for year-to-date. This way it is easy for the reader to analyze the numbers. Showing percentage changes does not present the full implications of any surplus or shortfall by category.

Conservative Budgeting

A great deal of work needs to happen before the budget is presented to the full Board for approval. On the revenue side, it needs to create a worksheet document with three categories labeled "Certain", "Reasonably Certain" or "Uncertain/Possible" or using some similar nomenclature. It could also have a column in the worksheet document by each source that gives the percentage of the likelihood of funding instead of the three columns. The real point of this exercise is to create a conservative income-based budget. Only revenue items that the organization is confident that it will receive should be added to the budget projections.

It is imperative that the income side of the budget be created first. Unfortunately many nonprofits create expenses budgets first and then try and plug in the revenue items so that it balances. This



usually leads to unrealistic revenue projections. As an example, the FYE2008 budget has the following line items and related amounts:

- a) Fee for Service (Arts/Education) of \$50,000 that we were told references the licensing of Mariachi Youth Education;
- b) Advertising Revenue of \$50,000 that references income generated from an electronic billboard sign that MHC wants to place on the front of the Plaza building but has not had approval for the City to do so;
- c) Consulting Fees of \$20,000 this might be related to Mariachi Youth Education or the Mariachi Festival itself or any number of other ideas; and
- d) Foundation RAP Rental Support of \$70,000 that it wanted to generate by having the RAPs help make requests to its own funders asking those foundations to make contributions to MHC on the RAP's behalf since the RAPs are currently paying rates for renting the facility that are below MHC's standard nonprofit rate.

In our opinion, all of the items should not have been added to MHC's FYE2008 budget unless it was reasonably certain that it would be able to generate this projected income. According to the RAPs they were presented with a task of helping MHC generate \$70,000 in revenue to support the organization in the fall — several months after the start of their own fiscal year and well after they had already made their own fundraising and development plans. No concrete plans based on realistic revenue assumptions and projections exist yet for electronic billboard and curriculum licensing plans. These four items total \$190,000 and through the first six months of the year no income has been received from any of these categories.

We requested but did not receive any organizational budgets versus actual for the prior years. The Auditor's report (March 2007) noted several issues related to them and the May 2007 Board Minutes stated that MHC was criticized for having a budget last year that was "too aggressive."

When we reviewed the FYE2006 budgeted versus year-end included in MHC's FYE2006 Grantee Final Report to the City of San Jose Office of Cultural Affairs we noted that there were several instances where the actual income items were much less than budgeted.

Recommendations:

- 1. Create worksheet documents that identify the sources and types of income. MHC should also include the amounts of funds for all of the items that are contained in each category as well as a way to determine how likely the organization is to receive these revenues.
- 2. Only include revenue items that MHC reasonably believes it will receive or earn during its fiscal year.
- 3. Use the General Ledge line item categories when creating any budgets. If the organization feels it prudent to create sub categories within larger categories, by all means do so, however, provide all of the detail in the budgets and not just the broad category totals. This way it will be easy to generate the reports and review budget progress.



Income Restrictions

Nonprofit accounting standards required organizations to use the following classifications for reporting their income: unrestricted; temporarily restricted; income release from restriction and permanently restricted. Not all of the categories apply to MHC currently as no permanent endowment exists nor has it received any such gifts. The Auditor allocates income to these classifications in MHC's audited financial statements.

Unrestricted income relates to general operating support that can be used by the organization where ever it deems a need in its current fiscal year while temporarily restricted revenue has been given with donor-imposed restrictions, meaning it can't be used to pay any expenses other than for what it has been sanctioned. As an example, arts education program grants can only be used to pay the expense of the Mariachi Youth Education.

Recommendation: We suggest that MHC's accounting system classifications be changed to incorporate these additional revenue categories for all of its contributed income sources: foundations, corporations, and public agencies.

Program Budgets

A best practice is for nonprofit organizations to create program budgets (functional operating budgets) that allocate direct and indirect costs. All of the program budgets together equal all of the revenues and expenses listed in the organizational budget. We have discussed this in some detail in the O&M Report. (Appendix 2: Pages 75-76)

A brief description of the process is as follows: income received by the organization specifically designated to support a particular program or generated by a particular program is assigned to the appropriate budget as is a portion of the organization's unrestricted income using an allocation methodology that makes the most sense for the organization and is approved by the Board's Finance Committee. On the expense side, direct personnel costs of program staff is allocated to the budget along with any direct program expenses. Indirect costs, which include the salaries of administrative, marketing, development, general and finance staff; audit and accounting fees and other general organizational expenses, such as marketing and fundraising are allocated to each program based on a method that makes sense to the organization. Allocation methods include indirect expenses as a percentage of total budget expenses or indirect expenses as a percentage of salaries, which requires staff to allocate how they spend their time.

Until this year, MHC never created program budgets. The ones that we have been sent to review are for the 2008-2009 fiscal year. While we are pleased that the organization has made an attempt, the budgets need to be tweaked so that all programs have direct program staff costs allocated to them as well as a percentage of all of the administrative, development, and marketing expenses.

The only way for us to review whether or not one of MHC's program was breaking even, showing a deficit or creating a surplus was to review the department budgets. This was difficult as historically there were no consistent rules regarding the allocation of revenues and expenses. We believe the lack of program budgeting is one of the reasons why MHC has never able to determine how much it actually cost to operate and maintain the Plaza as a program. It never tracked in one financial statement the O&M subsidy received, allocated portion of general operating support from grants



and individual donor plus the income generated by renting the facilities. (Specific revenue generated from MHC Presents tickets sales would not be included in this budget as this earned income would be allocated to its own program budget.) On the expense side, appropriate staff expenses, direct program costs (in this case the maintenance of the facility) and a percentage of its indirect staff costs would complete the expense side of the budget.

Creating program budgets does not mean that the organization forgoes creating budgets for administration, development and marketing department; to the contrary. It means that the sum of these budgets is allocated to all of the other programs by an allocation method that makes sense for the nonprofit.

Recommendation: MHC should create proper program budgets like those just described. It will also be useful to the organization to create sub budgets for some of the programs. For instance, it might want to create a Mariachi gala budget, an outdoor concert budget, and one for mariachi education workshops. It will need to allocate the appropriate staff costs to each as well as a percentage of the organizations overhead as we described (administrative costs etc.) All of these sub budgets should then be included in the principal program budget which in turn rolls up into the organizational budget.

Selected Income Analysis

Facility Rentals

Much has been written in the Plaza Consultant's report on Facilities Rental income (January 2008 Alvarez & Borrrup) so we are not going to discuss this income category in detail.

• MHC budgeted \$330,000 of income for facilities rentals including the Resident Art Partners rental of offices and theater/pavilion. For the first six months of the 2007-2008 fiscal year facilities rentals income was \$182,000 or approximately 55 percent of budget.

Mariachi Festival Program Income

The original Mariachi Festival budget had total revenue projections of \$865,500 and total expenses of \$582,300 for a net of \$282,200 while this year's Mariachi Festival only made \$71,941 after all of the bills were paid

• A best practice is for nonprofit organizational and program budgets to reference cash and not assets. Included in the 2007 final Mariachi Revenue and Expense statement under revenues is equipment donation of laptops valued at \$71,000 that were given to MHC in return for sponsorship benefits. These computers are donated items and will be recorded as an asset on MHC's balance sheet. The audited statements will list the \$71,000 in-kind donation in revenues and will list an offsetting expense of \$71,000 of equipment in the Statement of Functional Expenses. The latter occurs because accounting rules assume an organization would have purchased the item if it had not been donated. The auditor will presumably list the donation in its footnote covering donated products and services.



Neither the Mariachi Festival program budget nor final revenue and expense statement projects or accounts for in-kind donated media sponsorships. In our opinion, this year's final accounting of the festival and its components should not have listed the value of the donated laptops in the revenue side of the festival final income and expense statement. This is not a GAAP or FASB issue but best practice related because the "net" at the bottom of the statement should reflect the cash income made from the program (festival, gala, and workshops) because cash pays the bills and not laptops unless they sell the equipment for cash.

MHC's Mariachi "net" line item in the organizational budget includes the value of the donated computers. Therefore it appears to the reader that the festival was more successful from a cash perspective than it really was.

• Ticket sales (admissions, gala, and workshops) combined were \$250,552 or \$117,948 less than projections of \$368,500 while Concession/Contracted Fees were only \$21,526 or \$90,474 less than budget of \$122,000. Combined public agency, corporate, and foundation support met budget projections of approximately \$385,000. The Festival netted \$71,941 in cash, which was \$211,269 less than projected or 24 percent. This program shortfall is one of the principal reasons why MHC is having current liquidity issues.

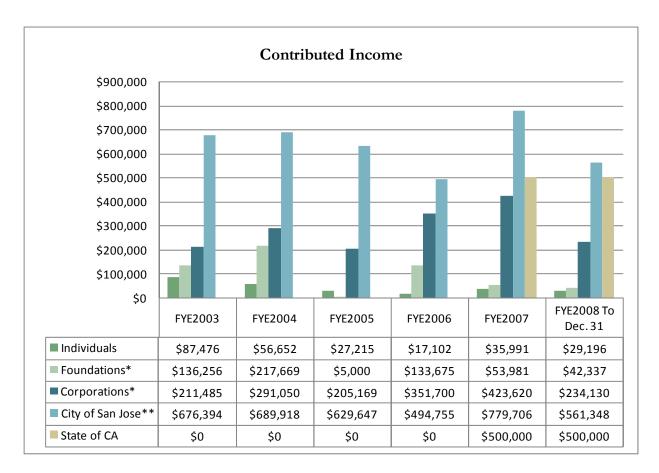
Recommendations:

- 1. MHC has to be mindful of its projected financial expectations and needs to prepare a conservative budget for the Mariachi Festival.
- 2. If MHC wants to include in-kind and donated products and services on a program budget, this is fine as long as they list the item on the revenue side of the statement and remove it on the expense side. Its financial accounting system should have a way to track donated assets.

Contributed Income

Diversified income sources are very important to nonprofit organizations for obvious reasons. MHC has been extremely dependent on the City of San Jose for the majority of its contributed income for the last five years as the chart below illustrates.

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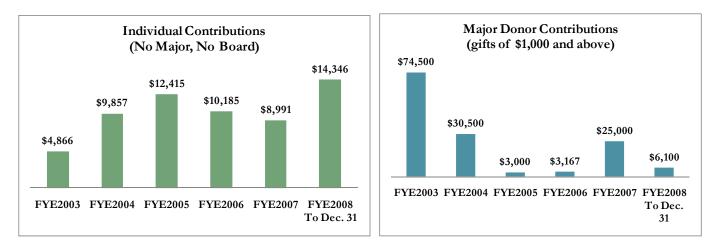


<u>Contributed Income Chart Notes:</u> These data points are from the consolidated Profit and Loss statements generated from the general ledger accounting system (MIP) with the exception of the data for the State of California capital improvement grant, which was supplied by MHC. The Foundation and Corporation totals include grants and sponsorships for all programs including Mariachi. The City of San Jose totals include funding from various sources and correlates to the chart listed in the O&M Report. (Appendix 2: Page 49) T

As noted in the chart footnote, most of the data is from the Profit and Loss statements ("P&L"). According to MHC, the State of California \$1,000,000 grant that it awarded to the organization to make capital improvements at the Plaza is not included in its P&L statements because according to MHC "the expenses were capitalized and not expensed" and therefore "do not show up".

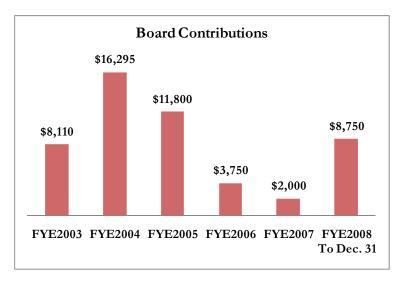
MHC did apply for and received the grant award in 2003. The work at the Plaza has been undertaken in FYE2007 and FYE2008 and MHC received \$500,000 in each fiscal year and made the equivalent financial investments in the facility's infrastructure. The graph shows that a great deal of its contributed income in the current and prior fiscal year came from the State of California in addition to the City of San Jose.

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Individual Contributions

<u>Individual Contributions Chart Notes:</u> These data points are from the consolidated Profit and Loss statements generated from the general ledger accounting system ("MIP"). We did not use the data supplied in the FYE2008 Budget versus Actual as we wanted to make sure that our comparison was to numbers from the same categories for all years, which included Individual Gifts, Employee Giving, and Subscriptions. Furthermore, we were not able to reconcile the amount included in this fiscal year's Budget versus Actual-to-date (December 31, 2007) statement to the P&L statement for the same time period. <u>Major Donation Contributions Chart Notes:</u> These data points are from the consolidated Profit and Loss statements generated from the general ledger accounting system ("MIP").



<u>Board Contributions Chart Notes:</u> These data points are from the consolidated Profit and Loss statements generated from the general ledger accounting system (MIP).

• The trend for individual contributions (gifts of less than \$1,000) is moving in a positive direction; however, as a percentage of contributed income it is still very low. As the Plaza Consultants noted it their report, many members of the community have not been happy with

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the direction that the programming at the Plaza has taken over the last three to four years and these low yearly totals could reflect this sentiment.

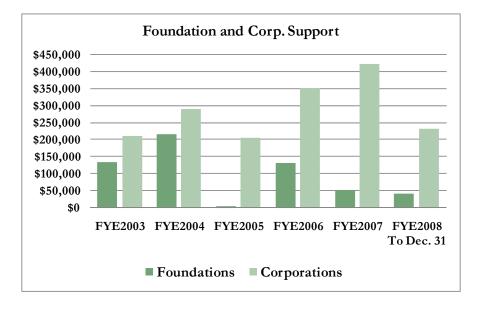
- A presentation was made to the Board of Directors (at the start or during this fiscal year document is not dated) regarding MHC's fund development plan. A slide stated that 85 percent of philanthropic support comes from individuals. For the first six months of this year, individual donations (including major donor gifts, gifts from employee giving campaigns, and Board donations) only totaled \$31,363 or approximately 6 percent of total contributed income.
- Individual gifts are typically a great source of general operating support for most nonprofit organizations. The cultivating of these contributions takes a concerted effort as does retaining the donor year after year. The donor has to feel invested in the organization and supportive of its mission and vision before it writes a check; large or small, to a nonprofit. Media stories on the state of the philanthropic sector routinely note that donors feel that they are making an investment in an organization and as a result expect to see achievable results demonstrated by the nonprofit. The data could suggest that over the last five years MHC has not demonstrated a strong connection between itself and a donor base.
- The 2007-2008 revenue budget projected \$37,000 of income derived from major cash gifts (\$1,000 and above) from individual and families. This represented a 48 percent increase from the previous fiscal year's actual revenue. As of December 31, 2007 MHC had only received \$6,100 or 16 percent of budget.
- The major gift prospect list presented to the Board at its December 2007 board meeting contains 54 names, including 24 individuals/families that do not have a gift on record with MHC. We note, however, that 21 of the targets had not made a contribution to the organization since FYE2003. In that year, nine gifts were in the range of \$1,500 to \$5,000, nine gifts of \$1,000, with the remaining gifts totaling between \$250 and \$500.

Recommendations:

- 1. While we think that the major gift threshold amount of \$1,000 is realistic, we were surprised that the prospect list was as short as it was considering the organization's self-characterization as a regional arts venue that draws audiences for its programs from the Bay Area and even Los Angeles. We recommend MHC greatly expand this list to 250 or 500 names, realizing of course, that cultivating this list will take between three and five years.
- 2. The challenge we see for the organization is that its largest program outside of the Plaza is the Mariachi Festival and most attendees view the latter as an event for which they purchase a ticket. MHC has to find a way to create a donor base from these festival attendees. It needs to connect the event in the public's mind with the Plaza and the corporation.
- 3. MHC's March 2007 Strategic/Business Plan and many of the Board of Director Minutes from May 2007 to December 2007 reference various good ideas on how it could expand its individual donor base. We urge the Board to establish a plan and aggressively start soliciting donations.



- 4. We know that the Board adopted a Board Responsibilities and Policies in May 2000 that states individual members have a responsibility to give personally to the organization. The Board must make sure that all directors are following it. We have not seen a board donor list so we are not able to comment on the percentages of directors who have made a cash gift or pledge by December 31, 2007.
- 5. The Board of Directors recently updated its annual financial support requirements for directors from \$1,000 to \$3,000 per member. While in our opinion this change is long overdue, we believe that for some board members, a \$3,000 gift is too low. We follow the philosophy outlined in *Board Match Plus: A Handbook for Prospective Board Members* published by the Volunteer Center Serving San Francisco and San Mateo Counties. It recommends that nonprofit board members make a "personally significant" annual financial contribution. As the handbook notes, board members have assumed a "special leadership position" that members have "not assumed for other worthy causes." It recommends that each board member ask him or herself if his or her gift would be considered generous by a "peer", defined as a "friend, colleague, business associate, or family member" and if said person found out what the board member had donated to the organization he or she would remark; "that is a generous gift you gave that organization."
- 6. MHC's Board Responsibilities and Policies Handbook reference the responsibility of the directors to solicit the companies for which they work for direct contributions and their friends and neighbors to buy tickets to the Mariachi Festival, events held at the Plaza, the gala, and to make direct gifts to MHC. We want to reiterate that all directors should continue to be actively engaged in fund development and the full Board should be updated at Board meetings on the status of all fundraising activities from the Fund Development Committee.



Foundation and Corporate Support



- Foundation grant support has not been a consistent source of revenue to MHC over the fouryear period charted above.
- Annual foundation support to MHC has been as high as \$275,000 in FYE2001 and as low as \$5,000 in FYE2005. Last year it was only \$54,000.
- The majority of corporate support has been in the form of sponsorships and not grants. In the last fiscal year MHC applied to only four corporate foundations for funding totaling \$85,500 and received a total of \$5,500 in two grants. Likewise, only four proposals were sent to family and private foundations with requests totaling \$450,000 and none were awarded. A grant of \$50,000 that had been applied for in FYE2006 was awarded and deferred to FYE2007.
- Almost all of the corporate and private foundation grant applications were submitted for project support versus general operating support. (See Appendix 1 for information on foundation funding and the grant application process.)
- There is a big distinction between sponsorship and grant support. The former is based on marketing considerations while the latter is based on the receipt and funding of a grant application. For event sponsorship support business usually evaluate the demographics of the attendees, invitation and/or planned marketing campaigns, media impressions and by other means. In the case of Mariachi, MHC's sponsorship package lists the value of media-sponsored advertising impressions and projected festival attendance.

Corporate sponsorships for Mariachi were slightly down from the 2007 festival when compared to the 2006 program, but at \$192,000 (not including the value of donated computers) shows great support for the event from the business community.

Recommendations:

- MHC has informed us that it has only recently had development staff again after it was required to lay off staff in FYE2005. We note that as a result it is now increasing the number of grant proposals it is submitting to corporate and private foundations and this is good news. The list, in our opinion, could be longer. We recommend that MHC conduct more extensive research on what private foundations might have program guidelines that MHC would be eligible to apply for funding and would be receptive to receive a proposal.
- There seems to be a perception from those outside of the philanthropic sector that it takes a miracle for an organization to be awarded general operating support from a foundation. That is simply not true as demonstrated by a sample list of grants awarded by arts funders who fund in San Jose in Appendix 1. It is true, however, that a general operating support grant is a vote of confidence in an organization: in its leadership, programs, and financial accountability.

Foundations want to support nonprofit organizations with vibrant programming that engages the community. They require that the conceptual framework that guides programming decisions be transparent, cohesive, comprehensive, and most of all rooted in community



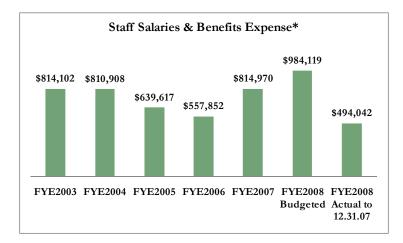
needs. Foundations also require that there is a rational believable explanation of how such needs have been gauged. In other words, in an arts/culture context, especially one rooted in an ethnic base, there is an expectation of intellectual capital in the expertise of that field along with a clear sense of the values that compel organizations to make certain programming decisions and not others.

If the majority of the programming that comprises MHC Presents are viewed as "one-off" events as noted in the Plaza Consultants Report (Alvarez and Borrup January 2008) by the local and philanthropic communities, it is certainly going to be difficult for MHC to be awarded either program or general operating support grants. If there is a thread that connects all of the events and programs that MHC presents, be they theater, dance, music, and visual arts, together, funding is much more likely.

Selected Expense Analysis

Staff Costs

In our O&M report (Appendix 2: Pages 68-72) we provided total staff salaries plus benefit costs for the fiscal years 2003 to 2007 with projected expenses for FYE2008 We included them in our analysis because MHC is requesting the City to cover 100 percent of the cost of several positions including the CEO, interim CFO and others. This section is now examining staff and benefit costs as a budget expense item.



<u>Staff Salaries & Benefits Expense Chart Note:</u> We have graphed the salaries and benefits expense totals from the audited financial statements for the fiscal years 2003 through 2006 and used the total of the following general ledger categories from the unaudited Revenue and Expense Statements for the fiscal year 2007 since the 2006-2007 audit is not finished: salaries, payroll taxes, payroll processing fee, health insurance, worker's compensation and other employee benefits. These are the categories that the auditor combines for "salaries and benefits" in the Statement of Functional Expenses.

Last year and this year, MHC contracted for an interim CFO and Accounting Manager through MACSA. While these individuals are not employees of the organization, they are considered "staff positions". Therefore, in order to compare all staff functions and related costs from the Audited Statements to this year's budget and actual expenditures



through December 31, 2007, we have added to the FYE2007 and six months of FYE2008 staff salary expenditures MACSA's fees as well as the fees paid to a temporary agency for a receptionist who is now an employee.

The totals by year in the chart above differ slightly from totals included in our O&M report because payroll taxes and payroll processing fee are included. The auditor adds these expense to create the "salaries and benefits" total listed in the Statement of Functional Expenses in the audited statements.

- According to the FYE2008 year-to-December 31, 2007 Revenue and Expense Budget vs. Actual Statement, "Personnel Costs" totaled \$449,011, which was 46 percent of the \$984,110 budget for this category. This is not accurate as the interim CFO informed us that while the fees for his and the Accounting Manager's consulting services were budgeted to "Personnel Costs" they have been expensed to the "Professional Fees" category in the organizational budget. The latter category was budgeted at \$52,000 and for the first six months of the year and actual expenses totaled \$98,135 and was 189 percent of budget.
- According to the General Ledger Statement of Revenues and Expenditures for FYE2008 through December 31, 2007, salaries and benefits expense for staff and contracted staff positions totaled \$494,042 and is 50 percent of budget.
- Staff costs have grown 76 percent or \$426,267 from FYE2006 to FYE2008 budgeted. By any standards, this would be considered a huge increase in only two years. It is especially troublesome for a nonprofit organization that had a small surplus of \$55,537 in FYE2006 and a projected surplus of \$163,410 for FYE2007 according to the unaudited General Ledger accounts. In addition, this projected surplus for last year was only achieved after the City gave MHC \$175,000 of one time additional funding in April 2007 to avoid a deficit.
- Salaries and benefit expenses present a real burden on the operating budget of the organization as this expense category creates a high hurdle for the organization to cover each year with earned and contributed income.
- As referenced above, MHC requested and received a special one-time payment from the City of San Jose for \$175,000 in April so that it could complete its FYE2007 fiscal year. This request for emergency funding, however, came in the same fiscal year the Board of Directors awarded the CEO a \$10,000 bonus and a \$45,000 raise. Although the raise was awarded in November 2006 and was effective in January 2007, her total compensation and benefits in real dollars for the 2006-2007 fiscal year was \$152,893, up from \$115,500 in the prior year.
- Total salaries and benefit expenses grew 46 percent from FYE2006 to FYE2007 or \$257,118. FYE2008 budgeted expenses for this category grew by almost 34 percent from the prior year: several staff members received raises and a Director of Operations was hired with projected salary and benefits of approximately \$81,000.
- Including the interim CFO and Accounting Manager, the numbers of staff positions have grown from 11 positions in FYE2006 to 13 in FYE2007 and to 16 in FYE2008.



Recommendations:

Our chart illustrates the trend in staff costs that were high in FYE2003 and FYE2004 and then started to decrease in FYE2005 and FYE2006 when the organization reduced staff and entered into its self-described "quiet period." Staff levels have started to rise again as the organization has added to staff and awarded salary increases.

Staffing levels, staff job functions and staff costs are challenges that every nonprofit faces. The decision of when to hire staff and for what functions are always considered carefully as are the decisions made related to staff cuts. We know that MHC is not an exception to this situation and that it values the hard work and dedication of its staff and the contribution that all of them make to the organization. We know that MHC, like all nonprofit organizations, wants to reward its staff with raises when it is financially feasible.

We preference our recommendations with a comment that MHC is not alone in dealing with budget shortfalls and the hard choices it has had to make related to staff positions and staff costs. Even national organizations that are considered well established with big budgets and big donor bases are not immune. In fact the American Red Cross announced February 1, 2008 that it was planning to lay off 1,000 employees or one third of its national headquarters staff because its leadership had determined that such cuts were necessary after it determined that its revenues were \$209 million short of its annual budget of approximately \$3.45 billion. (*The Chronicle of Philanthropy* 2/1/08)

It is very important for an organization to determine which staff members are integral to running the organization and what positions it feels that it can fill with consultants or temporary staff. These are choices. As an example, organizations have to decide how important is it to have full-time senior development staff versus development staff in training? How important is it to have a position filled by a consultant who is only in the office a few days a week versus hiring permanent staff? If income is tight, will the hiring of a new position that the organization deems essential require it to cut another staff position so that it can balance its budget? Often an organization's financial situation unfortunately does not allow it to offer what it considers to be market-rate compensation. Sometimes raises have to be frozen until the financial health of an organization improves and it has the financial capacity to pay higher wages. Unfortunately this is the reality of the nonprofit sector.

- 1. It is not a best practice to allocate various line items to one category and then show the actual expenses in another category. It is misleading because it appears as though one category is under budget while another is really over budget. The Board and City need to be able to review an accurate monthly revenue and expense statement.
- 2. MHC has to exercise extreme vigilance on its personnel costs. We know that the staff works hard and is dedicated but salary increases and bonuses should never be awarded unless the organization has the revenue and cash flow to justify the increase in expense.
- 3. MHC needs to constantly review its staff makeup in order to prioritize what positions are crucial to the organization. As an example, MHC did not have development staff from FYE2005 until this year and this impacted its ability to submit grant proposals and pursue individual donors.



Operations and Maintenance of the Plaza

We have already analyzed these expenses over a five year period and our assessment can be found in Appendix 2.

Cash Flow Forecasts

Cash flow, defined in its most basic terms is money coming into the organization through earned income or contributions (incoming) and what is disbursed to pay salaries, bills, and loans (outgoing.) These documents are invaluable to nonprofit organizations as unlike for profit business, most are usually very dependant on contributed income. MHC operating model is not the "norm" for most entities because in addition to receiving contributed income from individuals, corporations, foundations, and public agencies, the Plaza itself generates income from rentals while MHC Presents events and programs bring in ticket revenue.

We were provided with an organizational Cash Flow Profile for July 2006 to June 2007. We expect that this document was presented to the City last year as it shows a negative ending bank balance of (\$175,620.45) and according to its own bank statement its business checking account had a balance of \$217,976.81 on June 30, 2007.

We were also given a document titled "Projected Budget Outlook June 2007 to June 2008. It was not a true cash flow statement as it did not include beginning and ending bank balances for each month. This document projected a deficit of (\$304,550.98) at the end of June 2008. This document did have revenue and expense details but as we have already noted, the categories did not match those found in the organization's budget. In this document 2007 Mariachi Festival actual revenue and expenses are allocated within all of the categories on both sides of the financial statement.

Recommendations:

1. MHC needs to create forward looking cash flow forecasts that go beyond the end of a fiscal year. We suggest that MHC try and reasonably forecast 18 months out. It should always share this statement with the entire Board of Directors monthly.

The document should have a beginning date for each month and the cash position on the Beginning Date. It should have a total of cash receipts during the month (incoming) and then the cash disbursements (outgoing.). This will equal the cash at Month End. This total is carried forward to the next month. This document will immediately alert any reader to the months when the cash flow is projected to be negative.

2. We also recommend that the Finance Committee create a more detailed cash flow forecast that it reviews with the CEO and Executive Committee. Projected inflows will list actual names of revenue items such as grant of \$XX,XXX from Foundation A, O&M subsidy, School District Arts Education Fees etc. On the outflow side, the document will list the names of payables: PG&E, elevator service contract, webhosting fee etc. The Fund Development Committee will need to provide and/or review the information related to any fundraising efforts it is undertaking so that the statement has the most up to date information.



This is the document that should have been prepared and presented to the City for review along with its request for \$300,000 of emergency funding. The document would allow the Board to see all of the projected expenses and would enable it to see where it could cut expenses or delay payments. Until this document is produced it is extremely difficult to have a true sense of MHC's financial situation.

3. Cash flow forecasts should be rolling and not end in the last month of its fiscal year (June). The reader needs to know what is forecast for July and beyond.

Current State of Financial Affairs

As we have stated repeatedly, the financial statements are not consistent and as a result it makes it difficult to evaluate its current position with any degree of confidence. Here is an example of FYE2008 Income totals Year to date by month from the Budget versus Actual statements:

| | July '07 | Aug. '07 | Sept. '07 | Oct. '07 | Nov. '07 | Dec. '07 |
|----------------|-----------|-----------|-----------|-------------|-------------|-------------|
| Total Revenue | | | | | | |
| (Year-to-Date) | \$80,579 | \$239,111 | \$374,626 | \$495,906 | \$775,902 | \$901,391 |
| Total Expenses | | | | | | |
| (Year-to-Date) | \$115,346 | \$354,332 | \$246,987 | \$534,982 | \$827,737 | \$956,603 |
| Over/Under | | | | | | |
| Budget | | | | | | |
| (Year-to-Date) | (34,767) | (115,221) | \$27,639 | (39,076.00) | (51,835.00) | (54,916.00) |

FYE2008 Total Income Year-to-Date

Here is the same information from the Projected Budget Outlook July 2007 to June 2008 with actual income and expenses included through December 2007. This document includes Mariachi revenue and expenses while the first document included the "net". We would still expect that by December the Over/Under Budget (Year to Date) would match especially since MHC has informed us that it uses accrual accounting and all of its financial statements are based on this methodology:

| Projected Budget Outlook July 2007 to December 2008 | | | | | | |
|---|-------------|-------------|--------------|-----------|-----------|------------|
| | July '07 | Aug. '07 | Sept. '07 | Oct. '07 | Nov. '07 | Dec. '07 |
| Total Revenue | | | | | | |
| (Year-to-Date) | \$88,857 | \$198,131 | \$240,723 | \$529,966 | \$179,299 | \$146,809 |
| Total Expenses | | | | | | |
| (Year-to-Date) | \$139,019 | \$263,203 | \$410,807 | \$385,501 | \$161,701 | \$150,000 |
| Over/Under | | | | | | |
| Budget | | | | | | |
| (Year-to-Date) | (50,161.48) | (65,072.02) | (170,083.65) | \$144,465 | \$17,597 | (3,191.18) |

The differences do not end with these two documents as the Statement of Revenues and Expenditures from July 1, 2007 through December 31, 2007 shows total revenues of \$1,424,106.50 and expenses of \$1,578,023.13 for a net loss of (\$153,916.63).

While we have not been able to review correct cash flow statements for the organization all of the five amendments to the Operations and Maintenance Agreement support the conclusion that cash flow has been an issue for MHC since the 2001-2002 fiscal year:

• MHC requested and received an advance payment of \$178,443.75, equal to five months of O&M support for FYE2003 and a second advance and final payment for that fiscal year on



January 2003 for two months of support in the amount of \$71,377.50. The contribution requirement that it make payments to the cash flow "Reserve" account was also deferred.

- o An advance payment of \$34,482 for O&M support was made in FYE2006.
- An advance payment in the amount of \$275,855.28 equal to eight months of O&M support was made by the City in FYE2007 and MHC requested and received special one-time emergency funding of \$175,000.

Clearly MHC is depending on the O&M to pay the majority of its bills related to the Plaza and staff costs as this is the greatest constant source of revenue. In this current fiscal year it would appear that support for the Arts Education program was received starting in September. Most of the Mariachi corporate sponsorship revenue is received in August through October while ticket and gala revenue is mostly confined to October. Rental income seems to be a constant revenue source throughout the year with greater income earned in the summer and fall months.

The Mariachi Festival program requires the organization to expend a great deal of cash before the festival generates any money from ticket sales. Most of the festivals expenses are booked in August and September but are still high in October. Even though it receives grants and sponsorship support, the timing of these events undoubtedly does always sync with expenditures. As we have already noted, the net cash earned by the Mariachi Festival is extremely important to the organization as MHC does not have a great amount of financial support from individuals, foundations and corporations (non Mariachi.)

While the organization does have cash flow issues related to some of it program offering (dependent on ticket sales and sponsorships) other factors come into play related to its budgeting practices. As we have illustrated, MHC's financial issues are not solely based on cash flow challenges but are routed in organizational capacity issues as well.

The last balance sheet that we received was as of November 30, 2007 and it had the amount outstanding on the City loan listed incorrectly as \$550,001 when it should have read \$500,000. We do not know the true amounts of any of the asset and liabilities totals so we are not going to review an outdated statement. We are not going to examine financial ratios either as we do not have comfort in much of the current data.

Legal Obligations and Other Issues

We have reviewed MHC's agreements and numerous amendments with the City regarding the Operations and Maintenance Agreement and Loan Agreement related to the outstanding loan with the City. Based on the information that we were given up to December 31, 2007 our general finding is that MHC appears to be out of compliance with certain reporting requirements. It is our recommendation that the Board of Directors review all of these documents and well as all of the legal operating requirements for nonprofit organizations, making any corrections as necessary.



Operations and Maintenance Agreement and Amendments One to Five

We have already outlined our findings in a report presented to the City in January 2008. (Appendix 2) We noted that there was a great deal of financial information that MHC is required to present to the City including detailed organizational budgets; income and expense statements for six and 12 months; performance reports; and an exhibit with itemized financial information on how much it costs to operate and maintain the Plaza, amongst other documents.

The Fifth Amendment goes even further. Beginning with Fiscal Year 2007-2008 MHC is to provide the City with a monthly financial statement of income and expense, which it does. The agreement states; "MHC shall maintain a website where it shall make all financial information provided to the City available to the public for viewing and downloading for a period of at least 24 months. MHC shall post the information to the website no later than two weeks following delivery to the City."

While MHC's website contains the most recent and several prior audited statements and IRS Form 990ies, none of this year's budget versus actual statements by month are posted on the website nor are any of the other documents it has produced for the City. A power point presentation MHC made to the City regarding its cash flow issues is on the website but imbedded in a document under "Latest News." We could find no other financial information related to the 2007-2008 fiscal year.

Loan with the City of San Jose

The loan provisions require that MHC present to the City an annual business plan for the operation of the Plaza no later than June 1 for the next fiscal year. MHC is to outline and present programmatic performance benchmarks. The City Manager is also to be sent quarterly financial reports.

By-Laws

MHC amended and restated its By-Laws on November 15, 2007 to incorporate the revised statement of purpose (mission) that had been adopted by the Board in October 2003. We recommend that they review the rest of the document and make any other changes that might not be consistent with current practices. Specifically we note that Section 7 states that the Treasurer is the Chief Financial Officer of the Corporation and it lists the responsibilities of this position including the depositing of monies and the disbursement of funds. We do not know if MHC relied on board members to act as volunteer staff in 1997 but this description of the Treasurer's responsibilities seems more in line with staff than one of a fiduciary role.

Personnel Policies

We requested job descriptions for all staff and did not receive one for each position. While this might have been an oversight due to the sheer number of documents requested from MHC over the course of this project or issues with email on our end, we recommend that that MHC make certain that it has on file a written job description and list of current responsibilities for each position. We also recommend that the Board review these documents annually and make any changes as required.

Financial Policies and Controls

We requested copies of all financial policies and controls in place by MHC and we received three: Cash Routing, Check Routing, and Credit Card Transactions. All were in draft form so we were not sure if or when they were approved and by whom. Each document used staff member's first names



and not job titles so it was also hard to follow who was responsible for what and where the checks and balances are in place.

The Board packet and minutes from the July 2007 meeting contain a PowerPoint slide that was presented by the Interim CFO to the Board titled "MHC Finance and Accounting Control Summary of Accomplishments" and another titled "MHC Finance and Accounting Control FY 07-08 Plans." Clearly there are some financial policies and controls in place but we are not able to evaluate them as we have not been given the documents. Again, we did not know who created the policies and when, and if they were ever approved by the Board of Directors.

We recommend the Board review all existing policies and procedures, make changes if necessary, and approve those that have not been formally approved. The documents need to be contained in a manual and understood by all staff. We suggest that policies covers the following: receipts, disbursements, revenue and accounts receivable, expenses, purchasing and accounts payable, property and equipment, bank account reconciliation, record retention, and any other prudent policy related to MHC's operations

California Nonprofit Integrity Act of 2004

California Senate Bill No. 1262, also known as the California Nonprofit Integrity Act of 2004 requires all nonprofit organizations operating in the state to follow its requirements on charity registrations, audit requirements, audit committees, compensation reviews and fundraising accountability.

In June 2007 MHC's Board of Directors created the following committees: Audit, Fund Development, Board Development, Finance, and Nominating and Government. Both the Audit and Finance Committees are chaired by the Board Treasurer. Only one committee (Fund Development) has members according to the Board Minutes that we have reviewed.

We applaud the Board for creating individual committees but they might want to have one of the attorneys on the Board review the Act to determine if MHC needs to follow it or whether it is not applicable to MHC at this time. The California Nonprofit Integrity Act states the following: 1) Audit Committee members may not include the executive director, chief financial officer, board treasurer or other staff members; and

2) Committee members may include 50 percent of the finance committee members, exclusive of the chairperson of the finance committee. This act is applicable to organizations with \$2 million or more in gross revenue in any fiscal year, excluding government grants.

We recommend to MHC's Board that it appoints new chairs of the Audit and Finance Committees because whether or not MHC's prior and current fiscal year's gross revenue less government grants totals \$2 million or more, it is a good practice to have other board members overseeing these committees. We note that many nonprofits with annual revenue of less than \$1 million have audits and correspondingly have audit committees and finance committees and follow the spirit of this Act because it is simply another way for a nonprofit to have a system of checks and balances regarding its organizational finances and financial statements.

In addition, MHC's By-Laws provide requirements for Board committees that should be reviewed.



Board of Directors

Current board composition consists of 13 members and two Ex-officios. According to MHC's By-Laws there should be a minimum of five members. There is no maximum. Occupations of the board members currently include two educators, seven corporate executives, and four attorneys.

According to Article Three – Membership; "a minimum of two-thirds of the Board shall be from the Hispanic Community. Preference will be given to residents of the City of San Jose and the County of Santa Clara." While we do not know the ethnic make-up of the Board, eight of the 13 members live in San Jose and all but two of the directors live in Santa Clara County.

The recitals section of the Operations and Maintenance Agreement between the City and MHC state; "MHC is governed by a Board of Directors which is composed of representatives of the community in which the Facilities will be located. "Community" is not further defined in the document so it is unclear if this means residents from the Alum Rock Mayfair neighborhoods or from within San Jose proper.

According to the By-Laws (Section 5: Advisory Council, Honorary and Volunteer Support Group); "The Board of Directors may establish such advisory councils, honorary groups and/or volunteer support groups as it may determine are necessary to meet the Board purposes of this Corporation including for example, separate entities for Arts, Education, Business, Professional, Individual Artists, or Celebrities." The document further states that the "terms of appointment and expectations of service" shall also be determined by the Board.

Recommendations:

- 1. If the Board was looking to expand, we would recommend that it find new members from the philanthropic and marketing sector as well as those with management and artistic experience in the performing and visual arts and with accounting, banking, or financial management expertise. It would also be beneficial to appoint members with fundraising experience and deep connections within the San Jose and Bay Area communities.
- 2. Since the By-Laws give the Board the authority to create a number of program or communityoriented committees, we recommend that the Board consider establishing several committees or councils that could help the organization with program development and content, fundraising efforts, and volunteer services.

Strategic/Business Plan

MHC prepared a Business Plan in March 2007 and this document was referenced in the City Auditor's report as lacking in detail. The following was noted: "The MHC has not developed a strategic business plan or business model that articulates what programs, services, and events it would deliver with increased City funding. Absent a strategic, measurable, achievable, realistic, and timely business model or plan to address the aforementioned challenges, the MHC's ability to operate and maintain the MHP is highly questionable."

We agree with the findings of the City Auditors. We are going to comment briefly on the shortcomings of the current draft and provide recommendations on what it should change or add to



a new or revised version. We caution that it is difficult for an organization in crisis to create a well researched and thoughtful plan and our first recommendation is that MHC waits until it has a better sense as to its future direction before it embarks on the planning process.

Findings Related to Current Draft:

- The document provides five-year projected financial statements that are only valid if certain conditions were met such as the forgiveness of the City loan; the CA state grant was received; and \$700,000 of capital was given to the organization by the City and characterized as long-term subordinated debt.
- Many funding assumptions are made without the supporting documentation that tells the reader how the organization reached its financial projections.
- There is a great deal of organizational history and program descriptions but no analysis of its current state.
- A great portion of the document reads like a marketing plan. Elements focus on Hispanic Market demographics and market segmentation.
- The document does not analyze current program offerings nor explain how future programs were related to MHC's core mission.
- Funding forecasts make numerous assumptions. Without the supporting research it is unclear how realistic they are.
- Projected cash flow statements do not use any of the categories typically used by nonprofit organizations.

Recommendation: MHC needs to create a document that will articulate its mission, values, goals and strategize how it will serve the community (however it chooses to define it) with programming that has impact. The plan must provide specific objectives and describe the action steps that will be necessary to achieve them. The document must also address the resources (financial, staff, and other) that it will require in order to accomplish its specified goals.

We suggest that any plan include a section on finances; how it will generate income to operate its programs. We recommend that the plan have realistic income targets and include detail in the document on all assumptions and research findings contained within it.

It is important that the planning approach include the stakeholders of the organization. Programs must be evaluated to determine if any changes need to be made to the organization's offerings. There can be no sacred programs; all must be scrutinized to see if they are effective and are appropriately related to the mission of the organization. We suggest the new strategic/business plan contain specific strategies for achieving its goals and that these tactics are outlined in the document. We recommend that the document cover a future period of three to five years.



Analysis of New Revenue-Generating Ideas Considered by MHC

MHC has stated that it would like to charge for parking at the Plaza when events are held, install an electronic signboard on the building that could generate advertising revenue, offer naming rights to the Plaza in return for revenue, and license a mariachi youth curriculum. We have been asked to address these ideas.

Naming Rights and Electronic Signage

- MHC sent an email to the City in January 2002 with an idea that it wanted to pursue regarding selling naming rights for five different building or locations within the Plaza as well as installing an electronic sign. The organization listed an amount of \$2,000,000 that it thought could be generated from the plan but no proposal (with specific prospect s or analysis of how the estimated figure was derived) was ever submitted to the City for review.
- In August 2006 MHC notified the City it wanted to again explore this idea as a way to generate funds and marketing support for the organization. It cited the HP Pavilion as a local City-owned example where naming rights have been sold. Suggested areas for selling the naming rights include the entire Mexican Heritage Plaza or portions of the theater, theater lobby pavilion, classrooms, gallery, plaza, and gardens. This idea has been referenced by the organization in the media and other documents sent to the City but no plan or proposal has been submitted for consideration.
- A FYE2008 budget document included in the information on MHC's fundraising plans for the year listed an amount of \$83,333 that it had originally had budgeted for the licensing of naming rights. We have no idea how this amount was projected on the assumptions behind it.
- As mentioned above, MHC had an earned income line item in its FYE2008 budget of \$50,000 for advertising revenue, which we believe referenced revenue it could generate from an electronic billboard placed on the exterior wall(s) of the Plaza that would be visible from the street(s.) Again, no specifics were presented and we do not know the assumptions behind this projection.

Recommendation: This idea might indeed generate revenue for MHC if it remains as operator of the Plaza. The question is how much earned income might be realized and when could such a plan come to fruition? This is not a quick solution to its cash flow problem as there are many hurdles that must be first overcome. The organization has to undertake the necessary due diligence before a proposal can be presented to the City. The naming business is a complex field within the corporate branding sector, usually involving protracted negotiations.

A formal study must be undertaken by the organization that researches the following:

- 1. Interest in the idea from corporations, individuals/families, and foundations;
- 2. Potential reaction from its immediate neighbors, the Mayfair and Alum Rock community including neighborhood associations, as well as patrons and funders;
- 3. Investigates market rates (for buildings, classrooms etc.);
- 4. Explores the tenure of opportunities (length of naming period for various locations proposed);
- 5. Calculates realistic revenue generation and any associated expenses;

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- 6. Addresses legal issues;
- 7. How MHC would garner support from the community if the proposed idea is met with resistance; and
- 8. How MHC would address any neighborhood and community concerns so that the plan could become a reality.

We expect that it would need to hold community focus groups to weigh in on any formal proposal it plans on presenting to the City. And before it can do it would need to have a proposal that is somewhat solid –a prospect with a proposal in hand –otherwise it would be wasteful of the community's time and speculative.

The City also has its own policy regarding the naming of City-owned land and facilities that would have to be reviewed from a legal standpoint, and the City Council would need to vote on any proposal(s) since the Mexican Heritage Plaza is owned by the City and not MHC. Again, without specifics it would be hard to gauge the city policy and what the required steps would be to get approval for any proposal.

Charging for Event Parking

- MHC has stated to the media and in correspondence to the City that it would like to charge for parking at the Plaza. No details have been provided.
- The Operations and Maintenance Agreement between the City and MHC addresses parking (Section 29 pages 22-23) and it states that "any rates and charges to be imposed upon patrons Facilities for parking during special events" must be approved by the City's Director. It continues to state "the members of the public patronizing the Facilities shall be permitted to use the Facilities' parking spaces free of charge as space allows." There are approximately 287 parking spaces, with 20 of them reserved for use by MHC.

Recommendation: Our comments are almost identical to those regarding naming rights and electronic signage; MHC has to research the idea, create a proposal, and present it to the City for consideration. Specifically it needs to do the following:

- 1. MHC has to research what the liabilities are (if any) to the organization;
- 2. Calculate the costs for extra security and personnel; (This is where the idea of efficiency curves comes into play. Does the plan generate enough revenue to offset the expense?)
- 3. Research market prices;
- 4. Determine how it will collect the parking fees from patrons; and
- 5. Create specific policies and procedures for these cash transactions.

Most importantly, it must not penalize the patrons of the Resident Art Partners' events over those of MHC's own programs or only implement fee parking when the facility is rented by the public for events such as weddings or corporate meetings.

We expect that there will be a great deal of discussion that will have to take place between MHC, the City, and the Plaza's immediate neighbors on any proposal as we expect that event patrons who do not want to pay for parking will be looking for free parking in the neighborhood. Equally



important to address is whether it is even appropriate to charge for parking at a facility that was built expressly for the community.

We would like to propose an idea for consideration should MHC continue to be the operator of the Plaza: For large events, retain free parking for patrons in the larger lot off Alum Rock Avenue and offer valet parking with cars housed in the smaller lot off South King Road. MHC could partner with a valet company to assume the risk/liability, provide the personnel, park the cars, take the cash fees and in turn provide MHC with a portion of the revenue generated. Providing such a service might be enticing to corporations holding large events at the Plaza and for galas etc. Valets could be stationed in both lots so it would not be necessary for patrons to circle the building trying to find the valet entrance. This would solve the potential issue of patrons parking on neighborhood streets because free parking in the large lot would still be available. A pilot program could be tested for a few events to see what the demand is for the service and whether there was a valet company interested in partnering with MHC. The organization would still need to reach out to the immediate neighbors to present the plan and gauge their reaction to it and receive permission from the City for the plan as well as to set the parking prices.

Licensing Mariachi Youth Education Curriculum

MHC has expressed interest in expanding its after-school mariachi music program (which meets California standards for arts education) and, specifically, in licensing its curriculum/program to other school districts in the state.

Recommendation: We recommend that MHC thoroughly investigate this idea and find answers the following questions:

- 1. How big is the market for paid arts curriculum versus free lesson plans and other teaching tools already available on line?
- 2. As education budgets are tight throughout the state, what would entice a school district to purchase the curriculum? We note that some school districts such as Bakersfield City, California developed their own program internally.
- 3. How big is the market for a mariachi youth curriculum? The study needs specific answers beyond the demographics on the growth of the Hispanic population in the state.
- 4. Would MHC include teacher training as part of the program and if so, how much would these training sessions cost the organization and program?
- 5. Are there organizations that it could collaborate with on this idea?
- 6. Would funders be interested in providing funding to MHC as it conducts its study or to help underwrite a program of providing the curriculum to school districts for free?
- 7. MHC is already a member of MENC (the National Association for Music Education), which provides curriculum on its website for members to access from several school districts. MENC would be a good resource for MHC as well as the California Alliance for Arts Education.

Appendix 1:

General Information on Philanthropy from Private Foundations and Sample Grant Award Lists from Several Well-known Arts Funders

At the City of San Jose Rules & Open Government Committee Meeting on January 30, 2008, the Vice Mayor asked a question about philanthropy, grants, and the funding of nonprofits. We are presenting the following information as background to the section in the report on MHC's contributed income from foundations and corporations.

- Many foundations provide funding for specific projects with measurable outcomes and/or for general operating support or capacity-building activities. Some foundations also provide capital grants and technical assistance/planning grants.
 - <u>Project support</u> —for specific activities or events held within a set time frame, which is often the funding year, with achievable results as its outcome.
 - <u>General operating support</u> related to funding all of the activities of a nonprofit including staff salaries and overhead costs. Entities that provide this funding are investing in the entire entity and as such, show their belief in the mission and vision of the organization, the quality of its program offerings, and leadership of the CEO/ED and its board of directors/trustees.
 - <u>Capacity building</u> refers to strategic planning, organizational assessments, board and staff development, fund development, work to initiate or strengthen collaborative efforts or other efforts to strengthen the organization and help it achieve its mission.
 - <u>Planning/Technical Assistance</u> can be provided to organizations contemplating major changes to its programs or physical plant.
 - <u>Capital Grants</u> helping organizations with facility purchases, expansions, or renovations.
- Each foundation determines its mission, vision and goals as well as the parameters of its grants program, including its areas of interest and geographic focus. Each entity determines its own benchmarks and eligibility for funding. Some foundations have a competitive grants program with an open application while others are by "invitation only." The schedule for submitting applications and announcing grant awards varies from foundation to foundation. The application process and materials requested for submission by the nonprofit applicant is unique to each foundation as is the internal review process as well as the size and term of the grant.
- <u>Grant Terms</u> are specified by the funder. Some foundations have set time frames such as one year while others might offer multi-year grants. Sometimes funding in the second or later years is dependent on the organization submitting a grant report that outlines how the grant funding was used, what performance objectives were achieved, and progress of the project or organization related to stated goals in the initial grant proposal.
- <u>Grant Amounts</u> as stated above, these vary from foundation to foundation, however, they are usually dependant on the program budget, size of organization's budget, other funders supporting the organization and/or program and at what level, written proposal content, site visit, and interviews with key staff members including the ED/CEO or program staff and sometimes members of the board of directors.

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• <u>Grant Proposals</u> — each foundation's application is unique although most applications require a written narrative on need, how the organization is going to address the issue(s) it has identified or run the program for which it is seeking support, and a list of specific objectives and desired outcomes that will be achieved if funding is provided to the nonprofit. Most applications also ask the organization to identify how it will evaluate the program and measure progress and successful outcomes. Some applications ask about the organization's capacity and how it will implement the proposed work while others ask for a risk analysis outlining the possible barriers to success, including how the organization would work around potential shortfalls in funding.

Sample Foundation Grants from well-known arts funders who fund in San Jose

| Ford Foundation Grants | Grant Period | Grant Amount | Grant Purpose |
|---|---------------------|--------------|---|
| African American Cultural Center of Greater Pittsburgh | 2005 - 2006 | \$63,705 | For the African American Cultural Participation Initiative to heighten the awareness of African American arts programs in the Pittsburgh area |
| Alaska Native Heritage Center | 2006 - 2008 | \$150,000 | For activities to foster dialogue between Alaska Native artists and the public, strengthen cross-cultural understanding and build appreciation |
| African Continuum Theatre Coalition, Inc. | 2005 - 2007 | \$50,000 | for Native arts in the region For expansion of Fresh Flavas, a series of staged readings of works-in- progress by playwrights followed by public discussions and feedback |
| American Indian Community House, Inc. | 2006 - 2007 | \$50,000 | from directors For performing and fine arts activities serving the New York City Native-American community during the organization's transition to a new location |
| La Pena Cultural Center, Inc. | 2005 - 2009 | \$150,000 | To expand its Next Generation initiative and enhance its Latin American/Caribbean and Community Action programming |
| Atlatl, Inc. | 2006 - 2008 | \$100,000 | Tie-off support for organizational development to increase its effectiveness in serving contemporary Native American artists and arts organizations |
| August Wilson Center for African American Culture | 2007 - 2008 | \$200,000 | Core support for its national theater initiative to create a sustainable network for the creation and presentation of theater developed by artists of African descent |
| The Edison Institute | 2007 - 2009 | \$2,132,000 | For the Henry Ford Museum to design "America's Transportation Stories," a permanent exhibit incorporating all of its transportation- related exhibits and their associated educational components |
| Lincoln Center for the Performing Arts, Inc. | 2006 - 2007 | \$15,000,000 | For the Bravo Lincoln Center Campaign to transform West 65th Street into a vibrant cultural corridor, modernize Alice Tully Hall and renovate the North Plaza |
| Native Arts Circle, Inc. | 2006 - 2009 | \$150,000 | General support to promote artistic development in the Native American community throughout the Great Lakes Region & educate the public to better understand native art & appreciate its significance |
| The Andy Warhol Foundation for the Visual Arts, Inc. | Grant Award | Grant Amount | Grant Purpose |
| National Museum of Mexican Art | Fall 2007 | \$60,000 | "The Immigration Project" exhibition |
| Museum of Contemporary Art Detroit: | Fall 2007 | \$60,000 | Publications and exhibition program support (over 2 years) |
| High Museum of Art / Woodruff Arts Center, Inc | Fall 2007 | \$50,000 | "After 1968: Contemporary Artists and the Civil Rights Legacy" exhibition |
| Center for Women and Their Work | Spring 2007 | \$80,000 | Exhibitions and publications (over 2 years) |
| MACLA/Movimiento de Arte y Cultura Latino Americana | Spring 2007 | \$75,000 | Exhibition program support (over 2 years) |
| Oakland Art Gallery | Spring 2007 | \$50,000 | Exhibition program support (over 2 years) |
| ZeroOne - The Art and Technology Network | Spring 2007 | \$70,000 | ZeroOne San Jose Global Festival of Art on the Edge |
| The David and Lucille Packard Foundation | Grant Award Date | Grant Amount | Grant Purpose |
| Mariposa's Art | 2007 | \$40,000 | For general support (over 2 years) |
| Next Door | 2007 | \$50,000 | For general support (over 2 years) |
| Spark | 2007 | \$20,000 | For general support |

| James Irvine Foundation | Grant Award | | Grant Purpose |
|---|---------------------|-----------------------------|---|
| | Date | and Term | |
| Community Youth Performing Arts Center | Oct. 2007 | \$225,000 (36 months) | To present Viva El Arte De Santa Barbara!, a series of performing arts residencies designed to reach the traditionally underserved Latino |
| Japanese American Cultural and Community Center | Dec. 2007 | \$500,000 (over 2 years) | To restore and enhance the James Irvine Japanese Garden. |
| Grand Performances | Dec. 2007 | \$300,000 (36 months) | To present artists from Latin America and Central/Eastern Asia, as part of Grand Performances' free summer season. |
| Los Cenzontles Mexican Arts Center | Dec. 2007 | \$225,000 (36 months) | For the "Living Traditions: Next Steps" project, including the creation of new musical works that expand upon traditional Mexican music and related performances in underserved communities throughout California. |
| Ford Theatre Foundation | Dec. 2007 | \$375,000 (36 months) | For the "Community Bridges Program," an outreach and audience- development initiative, to increase participation of traditionally underserved communities in the performing arts. |
| Napa Valley Symphony | Dec. 2007 | \$25,000 (12 months) | To present two concerts with Mariachi Cobre in celebration of Mexican Independence Day. |
| National Steinbeck Center | Dec. 2007 | \$25,000 (12 months) | To host a series of activities focusing on African American regional history and culture on the Central Coast and in Salinas Valley. |
| Historical Museum Foundation Of Sonoma County | Dec. 2007 | \$40,000 (12 months) | To collect and present multimedia stories from Sonoma County's Latino community. |
| LINES Contemporary Ballet | Dec. 2007 | \$300,000 (36 months) | For the creation of two world premiere works annually and to support dancer salaries. |
| Community Technology Foundation of California | Dec. 2007 | \$300,000 (24 months) | For a multimedia project designed to build stronger communities through youth-based and intergenerational programs. |
| Theatre of Hearts Inc | Dec. 2007 | \$40,000 (24 months) | For the expansion of after-school and weekend youth arts programming in low-income housing communities in Los Angeles. |
| Red Nation Celebration | Dec. 2007 | \$50,000 (18 months) | To support interdisciplinary performing arts for American Indian Heritage Month in Los Angeles. |
| Friends of The Levitt Pavilion | Dec. 2007 | \$20,000 (24 months) | For a series of free world music concerts in downtown Pasadena. |
| Teatro Vision | Dec. 2007 | \$275,000 (36 months) | To implement a new marketing and audience-development plan. |
| William and Flora Hewlett Foundation | Grant Award Date | Grant Amount | Grant Purpose |
| Oberlin Dance Collective | Dec. 2007 | \$2,000,000 | for facility renovation and construction, and theater rental subsidies |
| Magic Theatre | Dec. 2007 | \$29,000 | for an executive search |
| Cultural Arts Council of Sonoma County | Dec. 2007 | \$100,000 | for general support |
| Performing Arts Workshop | Dec. 2007 | \$150,000 | for capacity building |
| Z Space Studio | Dec. 2007 | \$15,000 | for general support |
| Diablo Regional Arts Association | Nov. 2007 | \$120,000 | for general support |
| Bay Area Video Coalition | Nov. 2007 | \$200,000 | for general support |
| CounterPulse | Nov. 2007 | \$120,000 | for general support |
| Los Cenzontles Mexican Arts Center | Nov. 2007 | \$250,000 | for capacity building efforts |
| Opera San Jose | June 2007 | \$390,000 | for general support |
| Intersection for the Arts | June 2007 | \$180,000 | for general support |
| Tannery Arts Center | Feb. 2007 | \$500,000 | for general support |

Source: Individual websites for each of the foundations referenced.



Appendix 2:

Analysis of the Operations and Maintenance Agreement between the City of San Jose and the Mexican Heritage Corporation (January 2008)

Document begins on the following page

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Analysis of the Operations and Maintenance Agreement between the City of San Jose and the Mexican Heritage Corporation

Submitted to The City of San Jose and the San Jose Redevelopment Agency

> Submitted by Strategic Philanthropy Advisors, LLC January 10, 2008

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Introduction

Strategic Philanthropy Advisors, LLC was commissioned by the City of San Jose in partnership with the San Jose Redevelopment Agency to undertake a financial feasibility assessment of the Mexican Heritage Corporation ("MHC"), the nonprofit operator of the City-owned Mexican Heritage Plaza ("Plaza") located at 1700 Alum Rock Avenue in San Jose in the Mayfair and Alum Rock community. This assessment was conducted in tandem with another consulting project led by Dr. Maribel Alvarez and Tom Borrup ("Plaza Consultants") that assessed the viability of the Plaza's existing operating model in terms of programs, vision, best practices, and community buy-in.

We have been asked to evaluate MHC's historical and current financial capacity; undertake an administrative and operational review of the organization; review its current legal obligations; review a draft Business Plan MHC presented to the City and to which the City Auditor found to be not fully developed; and work with MHC as it revises its Business Plan.

The Plaza Consultants started their assessment a month earlier than Strategic Philanthropy Advisors, LLC and our final report is due more than two months later. We plan to start working with MHC on its revision of its Business Plan after the CEO and Board of Trustees has had time to review and analyze the findings by the Plaza Consultants regarding the best use(s) for the facility and the community's aspirations regarding its use as well as the type of programming content it wants the operator to provide at the Plaza.

It has become apparent to us that one of the core issues centers on the cost of running the Plaza annually and the amount of the City's annual Operations and Maintenance ("O&M") subsidy paid to MHC as operator. How much has it cost to run the Plaza over the last five years?

The Operations and Maintenance Agreement ("O&M Agreement"), signed by the City and MHC in March 1996, outlined the "programmatic and organization" support that the City pledged to provide MHC as Plaza operator from 1996/97 to 1999/2000, and the "maintenance and operations" support it agreed to provide starting in 1998/99 and annually thereafter. The current annual O&M subsidy is \$413,783 per year.



In a letter to the former City Manager, from the President and CEO ("CEO") of MHC, dated June 5, 2006, the CEO stated; "Today, the City of San Jose provides less than one-half of the cost of facility maintenance, thus adding an operating burden to a young startup organization without sufficiently developed income sources. This puts the Plaza at a fundamental operating disadvantage that impacts its financial stability and degree of programming delivery."

Is the cost of operating and maintain the Plaza causing a financial burden on MHC? Is the magnitude of expenses related to the buildings, garden and parking lots responsible for a great deal of the organization's financial challenges over the last several years or since the Plaza opened? The Plaza Consultants' study will reveal that the community views the answers to these questions as central to the question regarding the facility's optimal uses.

How is "operations" and "maintenance" defined? What types of expenses should be included and what kinds of expenses should be excluded in the definitions as it relates specifically to the Plaza? Some of the terms in circulation (used interchangeable to refer to O&M) are: "facility maintenance," "facility upkeep," "occupancy costs," "operating costs," and "bricks and mortar." Does the definition of O&M include staff costs? How does the definition of O&M by the community compare to MHC's definitions and how do they relate to the definition of O&M as outlined in the O&M Agreement?

The answers to these questions have a direct relationship to how one calculates the costs to run the Plaza from an operational and maintenance standpoint. Each set of assumptions embedded in these question lead to a set of conclusions. This in turn correlates to the City's O&M subsidy and whether or not the amount provided annually is sufficient to cover such costs if, in fact, the O&M Agreement even requires the City to provide 100 percent of O&M costs. Or, if the City is not required to provide 100 percent of O&M costs, are there expectations held within the community (as revealed from the Plaza Consultants' fieldwork) that the City *should* be providing enough money each year to pay for all of the costs associated with operating and maintaining the Plaza?

MHC has had many conversations with the City and the two consulting teams over the last five months regarding its desire for an increased annual O&M payment and other financial remunerations. We asked MHC to provide to us in writing these requests and they are included in this report. As these financial terms are so much greater than what is currently being provided, Strategic Philanthropy Advisors, LLC felt that it was prudent to present the following assessment now in which we outline our findings related to how much we determined it cost to operate and maintain the Plaza over the last five years as well as our appraisal of the O&M Agreement before our complete report is due to the City. We also felt that it would be helpful for the City to read our O&M report in conjunction with the Plaza Consultants' report.

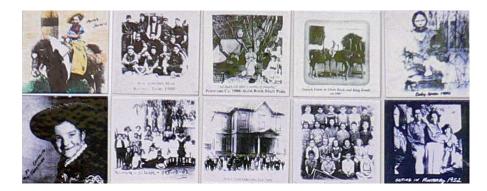
Strategic Philanthropy Advisors, LLC is not a law firm; there are no attorneys on the consulting team, nor any accountants. While we have a great deal of experience in the financial sector and the Project Leader, Margaret W. Southerland, Principal, has a banking and foundation background, our expertise is in the nonprofit sector. We have, used our professional and banking knowledge to determine how much it cost MHC to operate and maintain the Plaza over the last five years by reviewing and allocating 3,266 General Ledger line items contained in MHC's Profit and Loss



Statements for its fiscal years ended 2003 through 2007. We also analyzed MHC's audited financial statements and a great deal of other information provided to us by the organization.

The purpose of this Report is to provide information that will assist MHC's CEO and Board of Trustees and City staff and officials in addressing the predicaments over the management of the Plaza that they have faced in recent years. It is not our intent with this information to prescribe or foreclose any specific course of action. Any administrative and operational capacity issues implied by our findings can be addressed by the MHC organization and the City subsequent to this Report. The central issue comes back to the cost of operating the facility and the annual O&M subsidy. We have outlined several different financial scenarios related to O&M for consideration by the City.

Strategic Philanthropy Advisors, LLC is not in a position to decide how much money San Jose tax payers should provide to the organization annually nor recommend which of the several "best uses" for the Plaza is the most advantageous for the City. It would also not be appropriate for us to tell MHC's Board of Trustees whether it should remain at the Plaza as operators and programmers or, whether it would be best for them to concentrate solely on the Mariachi Festival and Mariachi Youth Education, or whether they have reached a point in their organizational lifecycle that merits considerations of more substantial financial and programmatic reorganization. We are in a position, however, to inform the conversation about the historical cost of operating the Plaza and how this financial data can be used by the two entities in discussions about the future of the Plaza and its operations.



Executive Summary

Strategic Philanthropy Advisors, LLC analyzed 3,266 general ledger line items from MHC's Profit and Loss statements for its fiscal years ended 2003 to 2007 in order to calculate how much it cost the organization to operate and maintain the Plaza over this period.

We began our research using expense categories and dollar totals by year for the fiscal years ended 2003 to 2007 based on audited financial statements provided to us by MHC in a chart titled "MHC Occupancy Expenses." We reconciled the expense categories and amounts with corresponding General Ledger ("GL") categories and line items from the Profit and Loss statements that were provided to us by MHC.

We removed specific line item expenses that did not pertain to costs associated with running the facility and were instead were directly related to programs such as MHC Presents, Mariachi Festival, Arts Education, Visual Arts Program, and weddings, quinceañeras and other events held at the Plaza. (We were able to review and sort costs by GL code; department; GL title; ID, which often contained vendor name; effective date; transaction description; and debit or credit amount.) If there was not enough information to determine why a charge was incurred, who the vendor was who provided the services or where an item was purchased, we gave MHC the benefit of the doubt and included the cost in our O&M totals. Next we added relevant expenses from categories we felt MHC overlooked but were indeed, in our opinion, costs necessary to run the facility such as permits, general liability insurance, retrofitting the Gallery, and supplies.

We compared each year's total costs to that year's City's O&M subsidy provided to MHC in return for the organization operating and maintaining the City-owned Plaza. MHC also receives use of the theater, galleries, gardens, Pavilion, Plaza, classrooms, and office space that make up the Plaza facility, and is able to generate income by renting these facilities to the public. MHC pays the City annual rent of \$1 each year.

Strategic Philanthropy Advisors, LLC determined that this subsidy, which totaled \$428,265 in FYE2003 (included a one-time cost of living adjustment of \$14482), \$413,783 in FYEs 2004-2006, and \$588,783 in FYE2007 (included a one-time special additional payment of \$175,000) was more than adequate to cover the operations- and maintenance-related costs for the facility. In fact, there was a surplus each year, and over the five year review period, this surplus totaled \$790,080.



| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|--------------------------------------|-----------|-----------|-----------|-----------|-----------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$2,258,397 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| Difference without staff costs | \$99,094 | \$102,033 | \$159,437 | \$113,362 | \$316,155 | \$790,080 |

The City and MHC's O&M Agreement, dated March 1996, states the following:

"MHC is expected to raise annual operating funding from outside funders, including corporations, foundations, individual donors and government grant-making agencies. MHC is also expected to generate revenues to pay for a portion of its annual operating expenses through ticket sales, memberships, rentals, sales of goods and services and other sources. MHC shall be solely responsible for the management of fiscal resources of the organization each year, and should not look to the City for supplemental funding."

The O&M Agreement contains a four-page matrix that clearly lists which items either of the two entities (MHC or the City) is required to service; cover preventative maintenance; pay for scheduled and/or emergency repairs; fund minor replacements; and pay for unit replacements.

The O&M Agreement states: "City's funding assistance ... *is intended to supplement* MHC's other funding sources", which we interpret to mean that under the contract terms, the City's annual O&M subsidy was never meant to cover 100 percent of the costs associated with operating and maintaining the facility. Our analysis of the financial data, in fact, has shown that the subsidy has actually done just that; it has covered 100 percent of the costs to operate and maintain the Plaza as outlined in the O&M Agreement.

As previously noted, the Plaza also generates earned income for MHC when it is rented to the public; to corporations, nonprofits, Resident Art Partners ("RAPs"), and individuals. It also receives grants from foundations, individuals, and other sources that help pay for general operating expenses. It also receives grants from entities, such as the Office of Cultural Affairs, specifically designated for MHC's programs such as Mariachi and youth education.

In fact, MHC has received a great deal of funding from various City budgets since the San Jose Redevelopment Agency built the Plaza for over \$33 million. The organization received start-up funding of \$885,480 prior to the Plaza's opening; a zero-interest loan of \$650,000 in July 2000; a special grant of \$500,000 in October 2001, Arts Grant Fuding of almost \$240,000 for its fiscal years 1997 to 2002; and Office of Cultural Affairs Festival, Parade and Celebration Grant funding for this same period of over \$55,000. These amounts total almost \$2.8 million. City contributions from all sources, including O&M, for FYEs 2003 to 2007 are provided by category in the following chart:



| City Contributions to MHC FYE 2003 to FYE 2007 | | | | | | | | |
|--|-----------|-----------|-----------|-----------|-----------|-----------------------|--|--|
| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years | | |
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 | | |
| City One-Time Cost of Living Adjustment | \$14,482 | | | | | \$14,482 | | |
| City One-Time Additional Funding | | | | | \$175,000 | \$175,000 | | |
| Office of Cultural Affairs Arts Grant | \$118,129 | \$187,135 | \$120,214 | \$60,839 | \$71,728 | \$558,045 | | |
| Office of Cultural Affairs Festival, Parade, | | | | | | | | |
| and Celebration Grant | \$30,000 | \$0 | \$20,000 | \$20,133 | \$20,195 | \$90,328 | | |
| Parks, Recreation and Neighborhoods | | | | | | | | |
| Services Grant | \$100,000 | \$89,000 | \$75,650 | \$0 | \$0 | \$264,650 | | |
| RDA/City Mariachi Festival Marketing | | | | | \$99,000 | \$99,000 | | |
| Total | \$676,394 | \$689,918 | \$629,647 | \$494,755 | \$779,706 | \$3,270,420 | | |

As the City's annual O&M subsidy covers 100 percent of O&M costs, any money generated from renting the facility can be used by the organization for whatever purpose it deems appropriate.

It also means that the RAPs have not been a financial burden on the corporation in the way it has been described. It is true, however, that the organization could have generated more income during the five year review period if the RAPs were charged MHC's nonprofit rate instead of the reduced rate agreed to by all of the entities in the "Mexican Heritage Corporation Resident Arts Program Operating Agreement" in July 2001.

The O&M Agreement does not specifically reference staff costs. Is there enough of a surplus to cover all of MHC's staff positions? The answer is "no."

MHC has informed the Consultants and the City that the annual subsidy should pay 100 percent of the staff salaries and benefits for the following positions listed in the chart below. The salaries and benefits expense totals assume that all staff positions are full-time and staff is paid for a full fiscal year that began July 1, 2007 even if this is not what has transpired. (More detail can be found in the footnotes of MHC's salary and benefit charts beginning on page 68 of this report.)

The CFO and Accounting Manager positions are currently provided by part-time consultants and the expense total listed for these "positions" is based on a full year of consulting fees charged for their services.

Strategic Philanthropy Advisors

MHC's Requests the Following Staff Positions be Paid by the City and Included in its Annual O&M Subsidy

Information is from Budgeted 2008 Salaries & Benefits

| | # of | | | Total |
|---|----------|-----------|-----------|------------------|
| | Months | | | Salary and |
| Staff/Consulting Position | on Staff | Salary | Benefits | Benefits |
| Accounting Clerk | 12 | \$31,200 | \$3,744 | \$34,944 |
| CFO and Accounting Manger * | 12 | \$77,400 | \$0 | \$77,4 00 |
| Custodian | 12 | \$24,960 | \$9,984 | \$34,944 |
| Customer Relations Associate and Assistant to the CEO | 12 | \$39,520 | \$7,904 | \$47,424 |
| Director of Operations | 12 | \$70,000 | \$11,200 | \$81,200 |
| Facilities Evening Supervisor | 12 | \$20,800 | \$4,784 | \$25,584 |
| Facilities Maintenance Manger | 12 | \$72,000 | \$25,920 | \$97,920 |
| Facilities Rentals Associate | 12 | \$33,280 | \$4,659 | \$37,939 |
| Facilities Rentals Manager | 12 | \$55,328 | \$11,066 | \$66,394 |
| President, CEO, and Executive Producer | 12 | \$150,000 | \$15,000 | \$165,000 |
| Theater Technical Director | 12 | \$45,032 | \$13,960 | \$58,992 |
| | Total | \$619,520 | \$108,221 | \$727,741 |
| * Consultants | | | | |
| Data supplied by MHC | | | | |

We calculated how much the staff positions listed in the chart above would have cost from FYE2003 to FYE2007. Some of the staff positions did not exist in prior years so we only totaled the actual costs.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|--|------------|------------|------------|------------|------------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$2,258,397 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| MHC's Proposed Staff Costs (Including Consltants in Lieu of Full-time Staff) (Salaries & Benefits) | \$360,312 | \$435,371 | \$442,860 | \$404,047 | \$522,094 | \$2,164,684 |
| Difference | -\$261,218 | -\$333,338 | -\$283,423 | -\$290,685 | -\$205,939 | -\$1,374,604 |

If the City agrees with MHC that it should have been paying for all of the staff positions contained in MHC's current request over this five year period, the City O&M subsidy would have been short between approximately \$206,000 to \$333,000 each year for a total of \$1,374,604 for the five-year period.

We note, however, that the following positions have many responsibilities and as such, are involved in many aspects of the organization including numerous programs. This means that each person does not spend 100 percent of his or her time on operating and/or maintaining the Plaza: CEO; CFO; Accounting Clerk,; Account Manager; Customer Relations Associate/Assistant to the CEO; and Director of Operations. While the Facilities Rentals Associate and Facilities Rentals Manager are responsible for renting the facility to the public and generating earned income for MHC, they are



also responsible for booking events and programs at the Plaza that are part of MHC Presents and other MHC programs.

Best practices in nonprofit budgeting specifically recommend that all direct expenses be allocated to programs while indirect costs are assigned to programs based on a portion of the organization's total program expenses or weighted by some other means. Administrative staff expenses (CEO, CFO, Accountants) and fundraising staff expenses (Development Director, Development Consultant, or Fund Development Director), are typically allocated by percentage to each program. Our preferred methodology is to allocate administrative and fundraising staff expenses to programs based on percentages of staff time spent on each program. As an example, because MHC's CEO is also the Executive Producer of the Mariachi Festival, the amount of her salary and benefits that equal what ever percentage of her time is spent on this festival and related education workshops should be allocated specifically to this program budget. The same is true for the time that the CEO spends on MHC Presents. Therefore, in our opinion, it would not make sense to include 100 percent of the CEO's salary and benefits in the organization's O&M costs for the Plaza. The same is true for the CFO, two accounting positions, Assistant to the CEO, as well as the Director of Operations as each position is also involved in all aspects of running the organization.

While the Plaza Consultants will discuss their finding regarding the community's definitions of operations and maintenance in depth, we understand from our own interviews and research that the majority of the community wants the City to pay for basic staff costs necessary to run the facility. These positions are comprised of the following: Custodian; Facilities Evening Supervisor; Theater Technical Director, and Director of Operations/Operations Manager/Facilities Maintenance Manager. (While the title has changed over the years we have tracked the costs by individual employee/position. We did not feel it was appropriate, however, to list the former and/or current employees by name.) We refer to this staff scenario as "Basic Staff Costs" as these are the minimum staff positions needed to make sure that the facility is cleaned, maintained, safe, and can be utilized by the public.

The question then becomes whether or not the City's O&M subsidy has covered the operations and maintenance costs for the Plaza as well as the "Basic Staff Costs" needed to take care of and operate the facility over the same five-year period.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|---|-----------|-----------|-----------|-----------|-----------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$2,258,397 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| Basic Staff Costs (Salaries & Benefits) | \$152,730 | \$184,224 | \$183,021 | \$195,517 | \$206,998 | \$922,490 |
| Difference | -\$53,636 | -\$82,191 | -\$23,584 | -\$82,155 | \$109,157 | -\$132,410 |

According to our analysis, the answer is "no" and the O&M funding deficit under this scenario varies from year to year, impacted by the total cost to operate and maintain the Plaza as well as the staff salaries and benefits paid to the staff positions that we consider included in the "Basic Staff Costs" scenario referenced above.



Over the five-year period, there was a total deficit of over \$132,000 after the O&M expenses and "Basic Staff Costs" salaries and benefits were paid. Staff salaries and benefits also increased over 35% or over \$54,000 over this period for these four positions, with the largest increase in total compensation paid to the Director of Operations/Operations Manager. We note these positions are identified by MHC as Facilities Maintenance staff in its new FYE2008 program budget; however, another operator of the Plaza might have another configuration for the positions to be included in "Basic Staff Costs." Furthermore, another Plaza operator might offer different compensation, or may organize its personnel and/or achieve different staff efficiencies.

As our analysis of MHC's financial statements show, the annual O&M subsidy of \$413,783, as outlined in the current O&M Agreement, has only been sufficient to cover the operations and maintenance costs incurred by the operator but not enough to also cover the minimum staff necessary to keep the lights on, clean the facility and make it available so that it can be used by the community if it wants to rent out the Plaza. Historically in order to cover these additional staff costs as well as the Consultant-calculated O&M expenses, the City would have needed to increase its annual O&M subsidy between \$16,000 and approximately \$82,000 per year. In the last fiscal year, the annual O&M subsidy received by MHC was much greater than outlined in the O&M Agreement as the City provided a special one-time additional payment of \$175,000. If the payment to MHC had not been increased, the organization would have been short \$65,843 to cover "Basic Staff Costs" salaries and benefits.

If the City intends to cover 100 percent of the operating and maintenance expenses of the Plaza as well as "Basic Staff Costs" needed to oversee the facility itself, the City will need to slightly increase the annual O&M subsidy MHC receives from its current level of \$413,783. This amount will need to be increased each time MHC awards raises to its staff members that comprise the "Basic Staff Costs" scenario.

Overview of MHC's Requests to the City of San Jose – as Operator and Programmer of the Plaza

MHC is requesting that the City increase its annual O&M subsidy of \$413,783 by \$886,217 to \$1,300,000 with annual cost of living increases.

We have outlined MHC's general requests by quoting MHC's CEO directly from an email that she sent to us on December 20, 2007. We have added a few notes in italic for clarification. More detail on MHC's full request can be found at the end of this document. We also quote MHC's CEO in this section as well.

"1) If the City and MHC mutually agree on a new operating model and programming vision, then the cost to support that model and vision, and the source of funds, must also be determined. Assuming there would be agreement on cost, we believe some sort of funding plan would include City funds, funding from philanthropy and earned revenue. It may or may not include a private sector financing partner."

This references naming rights for the Plaza or parts of the facility. In other correspondence with MHC, it has stated that it requests an annual O&M subsidy of \$1,300,000 per year with cost of living increases. It would also like to explore with the City bonus payments for mutually agreed targets related to the Plaza. These include creating incentives in energy usage and "greening" the facility as well as those related to revenue production and arts programming.

"In determining the amount of the capitalization of this new model MHC will ask for: a) re-characterization of its present debt to the City as a grant or forgiveness of the loan."

The loan was made in 2000 for \$650,000 at zero percent interest. Currently \$500,000 is outstanding. "b) reimbursement of the sums expended by MHC to subsidize the RAP in an amount to be mutually agreed upon."

"c) compensation to MHC for its recent \$1 million plus investment in the plant in an amount to be mutually agreed upon."

This reference is to a \$1,000,000 grant that MHC and the San Jose Redevelopment Agency jointly applied for in 2002, with funding received from the Sate of California in 2006 and 2007. Its purpose was to make capital improvements at the Plaza and was spent on upgrading the HVAC system, landscaping and other facility enhancements. The cost of the work did not exceed the grant. The Redevelopment Agency of San Jose and MHC jointly administered the project.

In a separate email from the CEO, she stated that the forgiveness to the loan should be tied to the compensation for the \$1,000,000 capital improvements made to the Plaza and that this would equal the forgiveness of the outstanding loan amount and "reimbursement" for the amount already paid back on the loan. Further clarification is needed from MHC as to whether or not these two items are indeed related or should be treated separately.

"2) If MHC is not selected to be the operator or if the new vision for the Plaza is not synergistic with MHC's mission and MHC's Trustees determine to terminate MHC's status as Plaza operator, then MHC would seek to negotiate an appropriate financial settlement with the City. The basis of the negotiation would focus on receiving compensation for b) and c) above, among other items."





The Operations and Maintenance Agreement between the City of San Jose and Mexican Heritage Corporation

The O & M Agreement between the City of San Jose and Mexican Heritage Corporation ("MHC") is dated March 7, 1996 and covers the operation and maintenance of what was originally called the Mexican Cultural Heritage Gardens project and is now called the Mexican Heritage Plaza. The agreement was entered into by the two parties before the construction of the facility was finished and it affirmed that the Redevelopment Agency of San Jose ("RDA") planned to transfer the site and the facilities to the City pursuant to a cooperation agreement between the City and the RDA dated March 25, 1996. After construction, the City owned the site and facilities and not the organization managing the property.

Recitals

The recitals section of the agreement state that the MHC is a California nonprofit corporation and is qualified under Internal Revenue Code section 501(c)(3). It is interesting to note that while MHC already existed as a nonprofit organization and presented community programs such as the Mariachi Festival, the agreement states that MHC was "organized for the purpose of developing, operating, and maintaining the facilities" and was to do so "in a manner that will enhance the City and best serve the needs of the community."

Another recital is MHC is governed by a Board of Directors, now called Trustees, "comprised of representatives of the community in which the Facilities will be located", implying that those with the fiduciary responsibility for the organization will live in the Mayfair and Alum Rock community surrounding the Plaza or at least in San Jose.

The Agreement notes that MHC "was organized for the purpose of developing, operating, and maintaining the facilities in a manner that will enhance the City and best serve the needs of the community." It also notes that "MHC has the necessary skill, background and expertise to operate and manage the Facilities on behalf of the City and desires to do so." The Trustees of MHC agreed that the nonprofit had the skill and experience to manage the property when in fact it had never operated and managed a facility with a 500 seat theater, gallery, gardens, pavilion, parking lot, classrooms, and office space before 1996.



<u>Term</u>

The term of the O&M Agreement is 15 years from the possession date, allowing for the term to be extended for two additional 10 year periods for a maximum term of 35 years. After this period, if the two entities wish to continue the arrangement, the City and MHC are "to meet for the purpose of negotiating a subsequent agreement on mutually acceptable terms." The document also has provisions for termination.

Facilities Standards

The agreement sets three standards for MHC to operate and manage the facilities:

A.) "To provide the highest quality of artistic and cultural programming to visitors to, and residents of, the city of San Jose" in accordance to an attachment which lists the mission or statement of purpose of the Plaza; a concept or user resource for the facilities; an educational philosophy which focuses on community resources and its relationship to the programs, services, performances, exhibits at the Plaza by MHC.

B.) "To make the Facilities available to the Public" as more fully described in another section which in broad terms discusses admission fees, MHC's "sole and full responsibility for managing, monitoring and supervising all use of the facilities."

C.) "To develop and maintain a capable, experience professional staff to operate the Facilities in a first-class manner."

Attachment B of the O&M Agreement outlines 'MHC's Use (Or Permitted Use.)" Three of these requirements outline a vision for the Plaza and how all of the facilities will be utilized by the community *or* to serve the community:

- "To the extent the Facilities are not programmed by MHC or its resident groups, MHC will make the Facilities available to other community and arts groups for performances, exhibitions, events and rehearsals."
- "In general, MHC shall give first preference to San Jose groups funded by the City through Arts Commission programs. Second preference will be given to other San Jose-based groups, followed by all other groups."
- "The goal of City and MHC is to serve the community by the maximum utilization of the Facilities for public performances, classes, exhibitions and recreation."

City and MHC Funding

As already noted in the Executive Summary of this report, the O&M Agreement provides a clear directive to MHC that it is "expected to raise annual operating funding from outside funders" in addition to a schedule of funding assistance that the City agreed to give the organization as operators and programmers of the Plaza.

The City initially provided "programmatic and organizational support" to the organization until the end of fiscal year 2000. This support totaled \$683,221 and was intended to help the organization transition from a small community-based nonprofit to one that was responsible for not only programming but also operating a large facility that included a theater, gallery, gardens, and



classrooms. Although this direct programmatic and operational support ended after four years, it was expected that MHC would apply to the Office of Cultural Affairs for competitive arts grants funding for the programs that it would be offering at the Plaza. To our knowledge, MHC has applied to the Office of Cultural Affairs each year and has been awarded for its efforts with at least one grant annually.

Additional funding support called "maintenance and operations" for the Plaza was also outlined and is, of course, the focus of this report. The support totals \$413,783 per year.

Maintenance and Repair Matrix

The Agreement contains a maintenance matrix that outlines in great detail which entity (City or MHC as nonprofit operator) is responsible for operating or servicing; scheduling planned maintenance (preventative); scheduled and emergency repairs; minor improvement; and for unit replacement for numerous items. These elements relate to the following:

- Structural facility;
- HVAC/electrical systems;
- Plumbing;
- Building safety systems;
- Furniture, fixtures, and equipment;
- Theatrical presentation systems;
- Landscaping;
- Outdoor structural elements;
- Outdoor plumbing and irrigation;
- Outdoor lighting;
- Outdoor furniture, fixtures, and equipment; and
- Parking lots.

The O&M Agreement is clear that MHC "shall provide at its sole cost and expense janitorial and maintenance services to the Facilities necessary to maintain the Facilities in a clean and serviceable condition for viewing and touring by the public." MHC is supposed to contract and pay for these services as well as an electronic security system and security services. While the City's O&M subsidy could be used to pay for these expenses, the City would not be contracting for the services and paying the bills directly.

Budgets and Audits

MHC is required to submit to the City the following financial information:

1. MHC's annual budget for the Plaza for "review, analysis and comment."

In addition, all subsequent budget revisions are to be reviewed by the City as well. Detailed information regarding projected income and expenses is to be submitted in addition to comparisons to budgeted and actual income and expenses for the prior fiscal year.



- 2. All submitted budgets and financial statements "shall contain a separate expenditure category entitled "Building Operations and Maintenance Costs." This itemized financial information is to include "an exhibit detailing the costs to operate and maintain the facilities." The agreement also requires the organization's budget for building operations and maintenance costs "be approved by the City."
- 3. Financial statements of income and expenses for six months and 12 months of each fiscal year.
- 4. Audited Financial Statements within 160 days after the end of the organization's fiscal year, duly certified by an independent certified public accountant.
- 5. A performance report for the year (after the fiscal year ended and accompanying the Audited Financial Statements) showing "operational performance, including without limitation, attendance, number and type of programs and outreach efforts."
- 6. MHC shall include in its annual budget "a minimum contribution of three percent of the budget to a cash flow reserve." MHC is required to make contributions to the reserve account until the amount in the account "has reached twenty-five percent of its annual operating budget. Other terms are outlined regarding this account and the amount of the reserve needed to be maintained over the term of the O&M Agreement and subsequent extensions, if they are entered into between the two entities.

It is unfortunate that the City and MHC have drifted from all of these financial reporting requirements over the years because they would have been useful tools for each of the partners to access how expensive it was for MHC to operate and maintain the Plaza since the facility opened as well as how the operational expenses were being budgeted by the organization over the last eight years.

MHC did indeed present the City with Audited Financial Statements and even basic organizational budgets for each of its fiscal years. An organizational shortcoming is that MHC never created specific program budgets for all of its programs until this fiscal year, and even this year's budget (07/08) was finalized halfway through its fiscal year (in December) by the staff and is to be reviewed and potentially approved by the Board of Trustees at their January 2008 meeting. The Plaza is most certainly a program albeit with two components; facility and rentals. There are both direct and indirect costs associated with any nonprofit budget and this topic will be discussed in the Scenarios section.

Strategic Philanthropy Advisors



How Much Does It Cost to Operate and Maintain the Plaza?

This section will have text that accompanies eight data charts that should be read progressively.

Chart 1: MHC-supplied O&M Expenses

MHC supplied both consulting teams with financial data on its occupancy expense expenditures for the fiscal years ended 2003 to 2007. We were informed that the data was from the audited financial statements. No staff salary and benefit costs were included. The only expenses listed were those related to facilities maintenance and those required to operate it on a day-to-day basis. Such expenses included cleaning, utilities, security, and maintenance items.

In each year, MHC's supplied operation and maintenance expenses totaled less than that year's annual operations and maintenance subsidy provided by the City. This subsidy totaled \$413,783 per year with the exception of FYE2003 when the organization received a one-time cost of living increase of \$14,482 for a total payment of \$428,265 and in FYE2007 when the City provided a special one-time payment of \$175,000 for a total payment of \$588,783.

MHC-supplied O&M Expenses

MHC has supplied the categories and data.

According to the organization, the numbers are culled from the audited financial statements, with the exception of FYE 2007, which is from the P&L statements.

Categories have been alphabetized.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | | | |
|--|-----------|-----------|-----------|-----------|-----------|--|--|--|
| Garbage | \$4,967 | \$5,873 | \$2,588 | \$2,757 | \$2,948 | | | |
| Maintenance Repairs/Contracts | \$81,686 | \$69,292 | \$35,610 | \$60,207 | \$48,475 | | | |
| Maintenance Supplies | \$8,067 | \$12,919 | \$12,215 | \$10,089 | \$11,395 | | | |
| PG&E | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 | | | |
| Rental Expense** | \$56,027 | \$46,146 | \$53,398 | \$51,601 | \$79,983 | | | |
| Security | \$71,996 | \$57,464 | \$48,441 | \$28,313 | \$27,066 | | | |
| Service Agreements | \$21,210 | \$15,029 | \$16,480 | \$6,031 | \$33,351 | | | |
| Telephone | \$18,974 | \$15,663 | \$22,947 | \$16,781 | \$15,379 | | | |
| Water Utility | \$11,063 | \$13,953 | \$13,868 | \$17,168 | \$16,664 | | | |
| Total | \$407,336 | \$354,848 | \$312,079 | \$344,181 | \$364,313 | | | |
| ** MHC footnote: "Donated rental value of \$630.1k and \$581.7k in | | | | | | | | |
| 2003 and 2004 respectively were taken out. Also, Equipment Rental is | | | | | | | | |

consolidated under this Rental Expense category.

Chart 2: Audited Numbers- Management & General (excluding Program Services & Fundraising)

We tried to replicate MHC's numbers using the Audited Financial Statements, however, the totals for each category and those totaled by year were much less than those supplied by MHC in its chart.

As the Statement of Functional Expenses in the audited financial statements breaks out the expenses by Management and General; Program Services; and Fundraising, we only used the Management and General expense line items as Program Service expenses will fluctuate based on the number of programs MHC runs as well as their scope and size. Fundraising Expenses, while much lower than the other two categories, typically included salaries and benefits, contract fees artists, and other expenses that do not related directly to the facility. We did, however, use the totals of all three categories for Utilities and Telephone.

> Strategic Philanthropy Advisors

Audited Numbers - Management & General (excluding Program Services & Fundraising) List of categories was supplied by MHC.

In the Statement of Functional Expenses, "Utilities" is understood to cover PG&E, Garbage, and Water Utilities, and it is assumed that "Contractors" must include Maintenance Repairs/Contracts and Service Agreeements. We have also added "Other non-labor" assuming that it might contain items that MHC has listed as "Service Agreeements", which might have not been included in "Contractors" or included in "Rental Expenses". We note, however, that the category "Supplies" might include supplies for programs as well as items related to facilities maintenance.

| Caregories have been apphabelized. | | | | | |
|---|--------------------|----------------|-----------|-----------|-----------|
| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
| Contractors | \$2,148 | \$33,196 | \$37,197 | \$6,327 | |
| Maintenance & Repairs | \$3,087 | \$2,606 | \$49,842 | \$67,861 | |
| Other non-labor | \$5,508 | \$10,008 | \$10,577 | \$3,450 | |
| Rental Expenses* | - | - | - | - | |
| Security | \$2,160 | \$1,724 | \$35,373 | \$13,281 | |
| Supplies | \$947 | \$1,235 | \$18,543 | \$9,252 | |
| Telephone | \$569 | \$470 | \$16,915 | \$9,640 | |
| Utilities | \$4,481 | \$4,150 | \$122,372 | \$170,098 | |
| | | | | | Not Yet |
| Total | \$18,900 | \$53,389 | \$290,819 | \$279,909 | Available |
| * The fair market value of the Plaza is included in the Rea | ntal Expense cat | egory for FYE | | | |
| 2002 to 2006 so this number has been removed from this | | | | | |
| Rental Expense is assumed to be equipment rental and the | refore has been in | ncluded in the | | | |
| data for that year. | - | | | | |

Categories have been alphabetized.

<u>Chart 3: Audited Numbers – Management & General (Excluding Program Services & Fundraising Allocations)</u>

Again using Audited Financial Statements (Statement of Functional Expenses) we tried to reconcile these figures with those provided by MHC. To do this, we added additional categories in order to try and equal the totals for each year; however, we were unsuccessful in matching MHC's financial totals by year.

Strategic Philanthropy Advisors

Audited Numbers - Management & General (excluding Program Services & Fundraising)

. . . .

Categories include potential matches with additional expenses added by Strategic Philanthropy Advisors, LLC that could be considered costs necessary to maintain the facility. As the reader will note, some of the numbers from the audited statements do not match those provided by MHC, which are suppose to be from the same documents.

| (| .ategories | have | been | alphal | petized. | |
|---|------------|------|------|--------|----------|--|
| | | | | | | |

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
|-----------------------|----------|----------|-----------|-----------|-----------|
| Contractors | \$2,148 | \$33,196 | \$37,197 | \$6,237 | |
| Insurance | \$822 | \$1,160 | \$25,467 | \$37,050 | |
| Maintenance & Repairs | \$3,087 | \$2,606 | \$49,842 | \$67,861 | |
| Other non-labor | \$5,508 | \$10,008 | \$10,577 | \$3,450 | |
| Rental Expenses | - | - | - | - | |
| Security | \$2,160 | \$1,724 | \$35,373 | \$13,281 | |
| Supplies | \$947 | \$1,235 | \$18,543 | \$9,252 | |
| Telephone | \$569 | \$470 | \$16,915 | \$9,640 | |
| Utilities | \$4,481 | \$4,150 | \$122,372 | \$170,098 | |
| | | | | | Not Yet |
| Tota | 1 19,722 | 54,549 | \$316,286 | \$316,869 | Available |

Chart 4: Profit and Loss Statement Allocations by MHC's Categories

In this chart we tried to match MHC's categories and totals with those from the Profit and Loss Statements. This time they did match closely. Although the interim CFO was informed that in the years before he started to work with MHC the General Ledger was always updated each year to reflect the auditor's findings, we were not sure if the P&L categories could be reconciled with similar categories in the audited statements. Our own financial analysis has shown that it is often hard to match exactly all of the profit and loss categories to the categories in the Audited Financial Statements. In regards to these particular categories, however, we were able to almost equal MHC's data for FYE2003 to FYE2007.

| P&L Statement Allocations by MHC's Categor Rental Expense excludes the cost of renting the facility from the Ca | | | | | |
|---|-----------|-----------|-----------|-----------|-----------|
| Categories have been alphabetized. | | | | | |
| ſ | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
| Equipment Rental | \$35,613 | \$26,034 | \$43,762 | \$47,916 | \$37,078 |
| Garbage | \$4,967 | \$5,873 | \$2,586 | \$2,757 | \$2,276 |
| Maintenance - Contract | \$69,816 | \$54,182 | \$33,299 | \$42,316 | \$37,763 |
| Maintenance - Repairs | \$12,745 | \$15,110 | \$2,312 | \$17,892 | \$10,192 |
| Maintenance - Supplies/Parts | \$8,067 | \$12,919 | \$12,215 | \$10,089 | \$10,229 |
| PG&E | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 |
| Rental Expense | \$20,499 | \$20,112 | \$9,637 | \$3,685 | \$38,732 |
| Security | \$71,996 | \$57,464 | \$48,441 | \$28,313 | \$23,241 |
| Service Agreements | \$21,210 | \$15,029 | \$16,480 | \$6,031 | \$33,351 |
| Telephone | \$18,974 | \$15,663 | \$22,947 | \$16,781 | \$15,279 |
| Water Utility | \$11,335 | \$13,953 | \$13,868 | \$17,168 | \$16,664 |
| Total | \$408,567 | \$354,848 | \$312,077 | \$344,181 | \$353,858 |



<u>Chart 5: Excluding expenses from MHC O&M Categories that are not directly related to the operations and maintenance of the Plaza</u>

We examined all of MHC's general ledger categories and removed expenses that were related to programs or facilities rentals. (Our methodology is discussed in detail in the section on Chart 7.)

| MHC-supplied O&M | Expenses | | | | | fter Items N e Were Excl | ot Related to | Operations | and | |
|--|--|-----------|-----------|-----------|-----------|-----------------------------|---------------|------------|-----------|-----------|
| MHC has supplied the cate | gories and data. | | | | | | | | | |
| Expense | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
| Garbage | \$4,967 | \$5,873 | \$2,588 | \$2,757 | \$2,948 | \$4,967 | \$5,873 | \$2,586 | \$2,757 | \$2,276 |
| Maintenance Repairs/ Contracts | \$81,686 | \$69,292 | \$35,610 | \$60,207 | \$48,475 | \$60,857 | \$57,595 | \$33,051 | \$52,051 | \$34,825 |
| Maintenance Supplies | \$8,067 | \$12,919 | \$12,215 | \$10,089 | \$11,395 | \$7,974 | \$12,451 | \$11,405 | \$9,978 | \$8,457 |
| PG&E | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 |
| Rental Expense** | \$56,027 | \$46,146 | \$53,398 | \$51,601 | \$79,983 | \$679 | \$2,660 | \$2,480 | \$1,618 | -\$676 |
| Security | \$71,996 | \$57,464 | \$48,441 | \$28,313 | \$27,066 | \$48,007 | \$31,482 | \$26,369 | \$4,603 | -\$1,610 |
| Service Agreements | \$21,210 | \$15,029 | \$16,480 | \$6,031 | \$33,351 | \$13,083 | \$8,676 | \$6,404 | \$6,031 | \$18,026 |
| Telephone | \$18,974 | \$15,663 | \$22,947 | \$16,781 | \$15,379 | \$18,974 | \$15,663 | \$22,947 | \$16,781 | \$15,279 |
| Water Utility | \$11,063 | \$13,953 | \$13,868 | \$17,168 | \$16,664 | \$11,335 | \$13,953 | \$13,868 | \$17,168 | \$16,664 |
| Total | \$407,336 | \$354,848 | \$312,079 | \$344,181 | \$364,313 | \$299,221 | \$266,863 | \$225,643 | \$262,219 | \$222,293 |
| ** MHC footnote: "Donau of \$630.1k and \$581.7k i 2004 respectively were takes Equipment Rental is consol this Rental Expense categor | n 2003 and 1 out. Also, idated under | | | | | | | | | |

In summation, we reduced the amount of expenses related to the operations and maintenance of the facility.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
|--|------------|------------|-----------|-----------|------------|
| Consultants' Data Per MHC's Categories - Totals | \$299,982 | \$252,970 | \$223,331 | \$244,520 | \$214,375 |
| MHC Categories & Data Totals | \$407,336 | \$354,848 | \$312,079 | \$344,181 | \$364,313 |
| Difference (or amount of <i>ineligible</i> O&M expenses per a review of all general ledger line items in MHC's | -\$107,354 | -\$101,878 | -\$88,748 | -\$99,661 | -\$149,938 |

<u>Chart 6: Additional GL Ledger Categories that Contain Expenses that the Consultants</u> <u>Believe Should Be Included as Operations and Maintenance Expenses</u>

Now that we understood the source of MHC's financial data (P&L statement categories and combined categories in certain circumstances) we examined all of the general ledger line items to determine if there were other expenses that should be added to this data. Were there other costs that MHC had possibly overlooked when it calculated how much it was paying each year to operate and maintain the facilities? Was there any structural work or one-time charges incurred by the Maintenance Department that might have been omitted on MHC's list because the expenses were not incurred each year?



After reviewing all of the Profit and Loss categories for five years, we added several categories: Insurance-General Liability (because the O&M Agreement stipulates that the organization must obtain such a policy and because it also requires minimum coverage limits); Gallery Retrofit, (which was work undertaken last year); Permits and Licenses, (which included elevator and sewer permits and other building safety system licenses); and Supplies, as some of the janitorial and office supplies were allocated to this line item.

| Additonal O&M Categories added by Consultant | | | | | |
|--|----------|----------|----------|----------|----------|
| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
| Gallery Retrofit | - | - | - | - | \$2,650 |
| Insurance - General Liability | \$25,824 | \$36,918 | \$24,149 | \$35,219 | \$38,040 |
| Permits & Licenses | \$2,492 | \$3,460 | \$2,841 | \$2,061 | \$804 |
| Supplies | \$874 | \$4,509 | \$1,714 | \$923 | \$8,841 |
| Total | \$29,190 | \$44,887 | \$28,704 | \$38,203 | \$50,335 |

We then reconciled MHC's category totals with our additional category totals.

| Reconcilliation of MHC's and Consultant's Data o | n Cost of Ope | erating the Pl | laza (Staff Ex | penses Not i | ncluded) |
|--|---------------|----------------|----------------|--------------|-----------|
| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
| Consultant-calculated O&M Expenses | \$329,171 | \$297,857 | \$252,035 | \$282,722 | \$264,710 |
| MHC's Data | \$407,336 | \$354,848 | \$312,079 | \$344,181 | \$364,313 |
| Difference (or amount of Ineligible O&M expenses as the expenses are related to programs or facilities rentals) | -\$78,165 | -\$56,991 | -\$60,044 | -\$61,459 | -\$99,603 |

<u>Chart 7: Consultant-calculated O&M Costs for the Years FYEs 2003 to 2007 based on the</u> <u>Profit and Loss Statement Categories' General Ledger Line Items per MHC's Categories</u> <u>with Additional Categories Added by Consultant.</u>

We were cognizant that in the early years of MHC's operations of the Plaza, there were not as many accounting policies as are currently in place by the organization with regards to the allocation of expenses. We asked to see an accounting of the various expense categories on MHC's list by general ledger code plus the entries for the additional categories outlined above.

Our O&M expense data was obtained by reviewing 3,266 general ledger entries for the years FYEs 2003 through 2007 as well as adding the totals for utilities (PG&E – gas and electric, water, telephone, and garbage.)

All of the general ledger items had been provided to us from MHC with the following information: department code, document number, identification code, transaction description, effective date, and debit/credit amount. We were also provided with the department codes so that we could see how various expense items were allocated within the organization. We also were given the profit and loss statement by department.

There were many instances where there was no vendor listed, description of item or other identifier. We gave MHC every benefit of the doubt in these instances that the expense was related to operations and maintenance of the Plaza and included the expense in our data.



We excluded expenses based on the following criteria:

- Facility Rental Department expenses incurred when the Plaza was rented by the public. Examples included linens; rental tables and chairs; janitorial cleaning expenses before or after an event; slide projectors, tripods, and other equipment needed by the client; and security for specific events. Many of the transaction descriptions noted if an expense was for a wedding or quinceañeras. We made an exception; however, when the departmental charge was identified as "Theater Supplies" because we were not certain if the expense was related to an event, MHC Presents, or the 500 theater facility itself. In all cases, we gave MHC the benefit of the doubt and retained these "theater" expenses as O&M-related costs.
- Gallery-related expenses were excluded if they were exhibition-related as these would be gallery program expenses and not O&M. At times it was difficult to determine if painting the gallery was maintenance and/or cleaning related or was incurred because an exhibit had left the Plaza or was being presented to the public. Again, we always gave MHC the benefit of the doubt. All gallery retrofit charges were retained as this, in our opinion, is a true O&M cost.
- Arts Program & Education Programs are just that: programs of MHC and are not related to the O&M of the Plaza. As a result we excluded guitar straps, instrument repairs, paint and contest supplies, and other related expenses.
- MHC Presents (includes the Mariachi Festival and other programs) and events held at the Plaza as these expenses are program related and are not true O&M expenses. This means that we excluded permits for the Mariachi Festival, security costs related to the event, equipment rentals, tables and chairs for concerts, and related items.
- Fundraising expenses for fundraising software was omitted within the Equipment Rental or Service Agreement categories because this is an indirect expense of the organization and not specifically related to operations and maintenance.

We included the following expenses:

• Administrative expenses related to MHC's office if they are part of one of the categories MHC included in its chart on O&M occupancy expenses. If it appeared, however, that an expense was not appropriately allocated, even though it was in MHC presents or Art Ed (as examples) we moved these expenses to O&M. Examples include costs for photo copy and postage machine rentals. Again, whenever possible, we gave the benefit of the doubt to MHC and included the expense in the total for the fiscal year.

<u>Chart 8: MHC General Ledger Titles with Additional Categories Added by Strategic</u> <u>Philanthropy Advisors, LLC with Expenses Grouped by Type and Not by Category</u>

| General Ledger Titles - Strategic Phila Expense | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
|--|----------------------|------------------|--|--------------------|---------------------|
| Equipment Rental: | 11122003 | 11122001 | 1112003 | 11122000 | 11122007 |
| Postage Meter | \$679 | \$1,422 | \$793 | \$1,291 | \$209 |
| Misc. Rentals | <i>Q(1)</i> | \$254 | \$1,353 | \$327 | -\$327 |
| Gallery Retrofit | | \$25 T | ψ1,555 - | <i>\\</i> 527 | \$2,650 |
| Garbage | \$4,967 | \$5,873 | \$2,586 | \$2,757 | \$2,270 |
| Insurance - General Liability | \$25,824 | \$36,918 | \$24,149 | \$35,219 | \$38,040 |
| Maintenance - Contract: | <i>Q23,021</i> | <i>\\</i> 00,210 | Ψ Δ 1,1 12 | <i>ф33,</i> 217 | <i>\\</i> 50,010 |
| Cleaning/Janitorial | \$20,851 | \$14,127 | \$7,770 | \$7,415 | -\$12 |
| Elevator | \$4,703 | \$8,706 | \$7,385 | \$7,773 | \$5,982 |
| Building Safety Systems | \$2,619 | \$2,400 | \$3,900 | \$3,900 | \$2,700 |
| HVAC | \$7,920 | \$8,356 | \$5,993 | \$11,276 | \$10,821 |
| Information Technology | ψ <i>1</i> ,720 | \$1,037 | ÷,,,,, | Ψ11 <u>3</u> =70 | \$2,423 |
| Landscaping | \$9,500 | \$6,565 | \$3,775 | \$835 | -\$470 |
| Misc. Maintenance | \$868 | \$334 | \$1,378 | \$2,185 | \$2,634 |
| Painting | #000 | | ÷,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,, | ~ ,100 | \$1,630 |
| Pest Control | \$2,502 | \$2,431 | \$540 | \$720 | \$1,080 |
| Phone/Phone System/Maintenance | ¢2,502 -\$97 | - | - | ¥720 | ψ1,000 |
| Refrigeration | Ψ, · · · | - | - | \$248 | - |
| Sweeping Services | - \$760 | - | - | φ210 - | |
| Maintenance - Repairs: | φ700 | - | - | _ | - |
| Building Safety Systems | \$3,703 | \$1,807 | \$480 | - | \$1,461 |
| Cleaning/Janitorial | φ 3 ,703 - | \$525 | φ400 - | - | φ1, 4 01 |
| Copy Machines | | \$209 | - | | - \$940 |
| Elevator | - \$872 | φ207 - | - | \$3,176 | φ/+(- |
| Fountain | \$100 | \$570 | - | φ3,170 | - |
| HVAC | \$5,889 | \$570 \$692 | - | \$205 | \$180 |
| Landscaping | \$3,005 | <i>\$</i> 072 | - | \$6,500 | \$1,735 |
| Lighting | - | \$2,374 | - \$277 | φ0,500 - | \$539 |
| Locksmith Services | - \$111 | \$425 | φ211 | - | <i>4337</i> |
| Misc. Maintenance | \$834 | \$6,016 | \$1,029 | \$4,091 | - \$1,930 |
| Painting | φUJT | \$0,010 | \$1,029 | \$2,062 | \$949 |
| Refrigeration | - \$481 | - | - \$525 | \$2,002 \$1,162 | <i>ወን</i> ትን |
| Theatre | φ τ οι | - \$1,020 | | \$503 | \$303 |
| Maintenance - Supplies/Parts: | - | \$1,020 | - | \$ 505 | \$ 305 |
| Cleaning/Janitorial | \$4,260 | \$4,977 | \$3,051 | \$2.027 | \$2,922 |
| Copy Machines | \$ 4, 200 | \$4,977 \$52 | | \$2,937 | . , |
| Flags | - | | - | - | - |
| Landscaping | \$456 | - ¢701 | - | - | - |
| Lighting | - ¢1.225 | \$791 | - \$2,704 | - \$2 710 | - |
| Maintenance Supplies | \$1,225 \$1,242 | - \$5.624 | \$2,704 \$5.340 | \$3,718 | \$830 |
| Maintenance Supplies Misc. Maintenance | \$1,342 \$602 | \$5,634 \$007 | \$5,349 | \$1,879 \$211 | \$3,414 |
| Misc. Maintenance Theatre | \$692 | \$997 | - \$201 | \$211 | \$221 |
| | - | - | \$301 | \$1,233 | \$1,070 |
| Continued | | | | | |



| Expense | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 |
|---------------------------------------|-----------|--------------------|----------------------|-----------|--------------|
| Permits & Licenses | \$2,492 | \$3,460 | \$2,841 | \$2,061 | \$804 |
| PG&E | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 |
| Rental Expense | - | \$984 | \$334 | - | -\$558 |
| Security: | | | | | |
| Building Safety Systems | \$1,868 | \$1,810 | \$1,679 | \$3,678 | \$2,055 |
| Locksmith Services | - | π- , , | π - j « · · · | \$452 | - |
| Maintenance Supplies Misc. | - | - | - | \$260 | - |
| Permits & Licenses | - | - | - | \$213 | _ |
| Security Patrols/Other Non Identified | \$46,139 | \$29,672 | \$24,690 | - | -\$3,665 |
| Service Agreements: | | | | | |
| Cleaning/Janitorial | - | \$130 | \$300 | \$350 | \$1,370 |
| Copy Machines | \$2,225 | \$966 | \$133 | - | \$398 |
| Elevator | - | - | - | - | \$2,104 |
| Building Safety Systems | - | - | \$316 | \$234 | \$1,590 |
| HVAC | - | - | - | - | \$2,162 |
| Information Technology | \$762 | - | \$1,250 | \$935 | \$2,173 |
| ISP Service | \$6,939 | \$4,101 | \$2,250 | \$1,425 | \$767 |
| Landscaping | - | \$548 | - | - | \$1,960 |
| Maintenance | - | - | \$601 | - | \$2,000 |
| Misc. Service Agreements | \$722 | \$968 | - | - | \$237 |
| Pest Control | - | | - | - | \$ 90 |
| Phone/Phone System/Maintenance | \$2,434 | \$1,963 | \$1,554 | \$3,088 | \$1,504 |
| Plumbing | - | - | - | - | \$1,235 |
| Refrigeration | - | - | - | - | \$437 |
| Supplies: | | | | | |
| Cleaning/Janitorial | - | - | - | - | \$2,088 |
| Flags | - | - | \$701 | - | \$347 |
| Landscaping | - | \$137 | - | - | \$1,449 |
| Lighting | \$128 | - | - | - | \$866 |
| Misc. Supplies | \$102 | \$1,776 | \$347 | \$242 | -\$507 |
| | | * • • • • • | | | |

As the chart shows, there were many similar expense types grouped within several categories. In fact not all of the allocations were consistent for the same vendor providing the same service.

-

\$18,974

\$11,335

\$329,171

\$643

\$1,064

\$1,532

\$15,663

\$13,953

\$311,750

-

\$22,947

\$13,868

\$254,346

\$666

\$54

\$626

\$16,781

\$17,168

\$300,421

\$2,055

\$2,543

\$15,279

\$16,664

\$272,628

The purpose of creating the next chart, therefore, was to group the expenses by type to determine if there were any particular expense categories that were unusually high in a particular year outside of the typically large expenses incurred for utilities and general liability insurance premiums.



Office Supplies

Telephone

Water Utility

Theatre

Total

In fact, the cost for Security Patrols/Other Non Identified is quite high for FYEs 2003 to 2005. This might be because the organization hired security guards for the Plaza or because it had a contract with a security company that provided details for events.

| General Ledger Titles - Strategic Philanthropy Advisors, LLC's Categories | | | | | | | | |
|---|-----------|-----------|-----------|-----------|-----------|-----------|--|--|
| All expenses were combined by type and not by ca | tegory. | | | | | | | |
| | | | | | | | | |
| | | | | | | 5-year | | |
| Expense | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Average | | |
| Building Safety Systems | \$8,191 | \$6,017 | \$6,376 | \$7,812 | \$7,806 | \$7,240 | | |
| Cleaning/Janitorial | \$25,111 | \$19,759 | \$11,121 | \$10,702 | \$6,368 | \$14,612 | | |
| Elevator | \$5,575 | \$8,706 | \$7,385 | \$10,949 | \$8,087 | \$8,140 | | |
| Gallery Retrofit | - | - | - | - | \$2,650 | \$530 | | |
| Garbage | \$4,967 | \$5,873 | \$2,586 | \$2,757 | \$2,276 | \$3,692 | | |
| HVAC | \$13,809 | \$9,048 | \$5,993 | \$11,481 | \$13,163 | \$10,699 | | |
| Information Technology | \$762 | \$1,037 | \$1,250 | \$935 | \$4,595 | \$1,716 | | |
| Insurance - General Liability | \$25,824 | \$36,918 | \$24,149 | \$35,219 | \$38,040 | \$32,030 | | |
| ISP Service | \$6,939 | \$4,101 | \$2,250 | \$1,425 | \$767 | \$3,096 | | |
| Landscaping | \$10,360 | \$8,611 | \$3,775 | \$7,335 | \$4,674 | \$6,951 | | |
| Lighting | \$1,353 | \$2,374 | \$2,981 | \$3,718 | \$2,235 | \$2,532 | | |
| Locksmith Services | \$111 | \$425 | - | \$452 | - | \$198 | | |
| Maintenance Related | \$3,736 | \$12,981 | \$8,357 | \$10,688 | \$14,013 | \$9,955 | | |
| Misc. Service Agreements | \$722 | \$968 | - | - | \$237 | \$385 | | |
| Misc. Supplies | \$558 | \$1,776 | \$1,048 | \$242 | -\$160 | \$693 | | |
| Office Supplies | \$2,904 | \$3,714 | \$926 | \$1,345 | \$3,602 | \$2,498 | | |
| Permits & Licenses | \$2,492 | \$3,460 | \$2,841 | \$2,274 | \$804 | \$2,374 | | |
| Pest Control | \$2,502 | \$2,431 | \$540 | \$720 | \$1,170 | \$1,473 | | |
| PG&E | \$133,346 | \$118,510 | \$106,532 | \$151,233 | \$129,054 | \$127,735 | | |
| Phone/Phone System/Maintenance | \$2,337 | \$1,963 | \$1,554 | \$3,088 | \$1,504 | \$2,089 | | |
| Refrigeration | \$481 | - | \$525 | \$1,410 | \$437 | \$571 | | |
| Rental Expense | - | \$1,238 | \$1,686 | \$327 | -\$885 | \$473 | | |
| Security Patrols/Other Non Identified | \$46,139 | \$29,672 | \$24,690 | - | -\$3,665 | \$19,367 | | |
| Telephone | \$18,974 | \$15,663 | \$22,947 | \$16,781 | \$15,279 | \$17,929 | | |
| Theatre | \$643 | \$2,552 | \$966 | \$2,363 | \$3,916 | \$2,088 | | |
| Water Utility | \$11,335 | \$13,953 | \$13,868 | \$17,168 | \$16,664 | \$14,598 | | |
| Total | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$293,663 | | |
| | | | | | | | | |
| Misc. Rentals expneses was added to Rental Expense | 5 | | | | | | | |
| Foundation and Sweeping expenses were added to La | ndscaping | | | | | | | |
| Flags expenses was added to Misc. Supplies | - | | | | | | | |
| Plumbing was added to Maintenance-related | | | | | | | | |
| Postage meter and copier expenses was added to Office Supplies | | | | | | | | |
| Painting was added to Maintenance Related | 11 | | | | | | | |

We added a column "5-Year Average" as we thought that it would be useful for the City and MHC to see the dollar average of each category over the review period. We expect that it will also be a useful tool for budgeting and for the MHC to incorporate into its new Business Plan.

Utilities expenses are always variable as usage as well as rates determines their yearly cost.



How much has it Cost to Run the Plaza for the Last Five Years with Staff Expense?

The answer to the question of how much has it cost to run the facility from FYEs 2003 to 2007 with staff depends on what positions are included in the analysis.

Before we delve deeper into this topic, and specifically as it relates to MHC's and the community's definition, we need to review the organization's staff positions by year as well as the salary and benefits for each.

We have recreated condensed charts for each year from data provided to us by MHC. We tried unsuccessfully to reconcile this salary and benefit data to the Profit and Loss Statements, to the Audited Financial Statements and to the organization's top salaries listed in their Form 990ies. For the purposes of this report we are taking the information provided by the organization at face value.

| | # 0I | | | |
|--------------------------------|-----------|-----------|-----------|--------------|
| | Months on | | | Total Salary |
| Position | Staff | Salary | Benefits | and Benefits |
| Administrative Assistant | 12 | \$35,806 | \$7,161 | \$42,967 |
| Administrative Assistant | 11.25 | \$44,172 | \$8,834 | \$53,006 |
| CEO | 12 | \$122,068 | \$19,531 | \$141,599 |
| Custodian | 12 | \$14,867 | \$5,203 | \$20,070 |
| Development Department | 3 | \$10,867 | \$2,173 | \$13,041 |
| Director of Arts Programs | 12 | \$60,701 | \$12,140 | \$72,841 |
| Director of Education Programs | 12 | \$34,063 | \$6,813 | \$40,876 |
| Director of Heritage Programs | 12 | \$46,523 | \$9,305 | \$55,827 |
| Director of Operations | 9 | \$54,090 | \$10,818 | \$64,908 |
| Education Department | 12 | \$34,045 | \$6,809 | \$40,854 |
| Facilities Evening Supervisor | 5 | \$10,250 | \$3,588 | \$13,838 |
| Facilities Rental Assistant | 12 | \$37,845 | \$7,569 | \$45,414 |
| Facilities Rentals Assistant | 2.75 | \$11,949 | \$2,390 | \$14,339 |
| Facilities Rentals Department | 1.5 | \$5,192 | \$1,038 | \$6,231 |
| Marketing Department | 3 | \$17,916 | \$3,583 | \$21,499 |
| Theater Technical Director | 12 | \$39,936 | \$13,978 | \$53,914 |
| | Total | \$580,289 | \$120,933 | \$701,222 |

| FYE 2004 Staff Salary & Benefits Expense | | | | | |
|--|-----------|-----------|-----------|--------------|--|
| | # of | | | | |
| | Months on | | | Total Salary | |
| Position | Staff | Salary | Benefits | and Benefits | |
| Administrative Assistant | 1.25 | \$6,665 | \$1,333 | \$7,998 | |
| Administrative Assistant | 8.5 | \$9,275 | \$1,855 | \$11,130 | |
| Custodian | 12 | \$15,210 | \$5,324 | \$20,534 | |
| Development Department | 6.75 | \$18,846 | \$3,769 | \$22,615 | |
| Director of Arts Programs | 6 | \$32,500 | \$6,500 | \$39,000 | |
| Director of Education Programs | 12 | \$35,530 | \$7,106 | \$42,636 | |
| Director of Finance and Operations | 8 | \$47,115 | \$7,538 | \$54,654 | |
| Director of Heritage Programs | 12 | \$51,700 | \$10,340 | \$62,040 | |
| Education Department | 9 | \$24,490 | \$4,898 | \$29,388 | |
| Education Department | 4.5 | \$12,693 | \$2,539 | \$15,231 | |
| Executive Director | 6 | \$65,769 | \$13,154 | \$78,923 | |
| Facilities Evening Supervisor | 12 | \$30,620 | \$10,717 | \$41,337 | |
| Facilities Rental Assistant | 12 | \$39,474 | \$7,895 | \$47,369 | |
| Facilities Rentals Assistant | 9 | \$28,308 | \$5,662 | \$33,969 | |
| Facilities Rentals Department | 12 | \$50,000 | \$10,000 | \$60,000 | |
| Operations Manager | 12 | \$49,039 | \$17,163 | \$66,202 | |
| Theater Technical Director | 12 | \$41,594 | \$14,558 | \$56,151 | |
| | Total | \$558,828 | \$130,350 | \$689,178 | |
| Data supplied by MHC | | | | | |

| FYE 2005 Staff Salary & Benefits Expense | | | | |
|--|-----------|-----------|--------------|--------------|
| | # of | | | |
| | Months on | | Total Salary | |
| Position | Staff | Salary | Benefits | and Benefits |
| Administrative Assistant | 12 | \$24,326 | \$4,865 | \$29,192 |
| CEO | 9 | \$76,731 | \$12,277 | \$89,008 |
| Custodian | 6 | \$6,416 | \$2,245 | \$8,661 |
| Development Department | 8 | \$26,639 | \$5,328 | \$31,966 |
| Director of Education Programs | 12 | \$35,544 | \$7,109 | \$42,653 |
| Director of Finance and Operations | 12 | \$73,096 | \$11,695 | \$84,791 |
| Director of Heritage Programs | 5 | \$21,719 | \$4,344 | \$26,063 |
| Education Department | 4.5 | \$14,269 | \$2,854 | \$17,123 |
| Executive Director | 6 | \$41,306 | \$8,261 | \$49,567 |
| Facilities Evening Supervisor | 12 | \$33,284 | \$11,649 | \$44,933 |
| Facilities Rental Assistant | 5.5 | \$16,978 | \$3,396 | \$20,374 |
| Facilities Rentals Assistant | 1.5 | \$7,647 | \$1,529 | \$9,176 |
| Facilities Rentals Department | 1.5 | \$5,769 | \$1,154 | \$6,923 |
| Operations Manager | 12 | \$52,212 | \$18,274 | \$70,486 |
| Theater Technical Director | 12 | \$43,660 | \$15,281 | \$58,941 |
| | Total | \$479,595 | \$110,262 | \$589,857 |
| Data supplied by MHC | | | | |



| FYE 2006 Staff Salary & Benefits Expense | # of | | | |
|---|-----------|-----------|----------|--------------|
| | Months on | | | Total Salary |
| Position | Staff | Salary | Benefits | and Benefits |
| Administrative Assistant | 3 | \$5,099 | \$1,020 | \$6,119 |
| CEO | 12 | \$105,000 | \$10,500 | \$115,500 |
| Custodian | 11 | \$17,370 | \$5,558 | \$22,928 |
| Director of Education Programs | 4 | \$10,278 | \$0 | \$10,278 |
| Director of Finance and Operations | 9 | \$61,916 | \$4,644 | \$66,560 |
| Director of Heritage Programs | 11.5 | \$44,231 | \$8,404 | \$52,635 |
| Director of Mariachi Youth Programs | 7.5 | \$23,176 | \$12,052 | \$35,228 |
| Director of Special Events (Facilities Rentals Manager) | 7.5 | \$19,754 | \$6,716 | \$26,470 |
| Facilities Evening Supervisor | 12 | \$29,690 | \$9,501 | \$39,191 |
| Operations Manager | 12 | \$56,673 | \$18,135 | \$74,808 |
| Theater Technical Director | 12 | \$43,724 | \$14,866 | \$58,590 |
| Data supplied by MHC | Total | \$416,911 | \$91,396 | \$508,307 |

| FYE 2007 Staff Salary & Benefits Expense | # of | | | |
|---|----------------|-----------|-----------|--------------|
| | Months on | | | Total Salary |
| Staff Position | Staff | Salary | Benefits | and Benefits |
| CEO * | 12 | \$138,994 | \$13,899 | \$152,893 |
| Custodian | 12 | \$24,133 | \$8,447 | \$32,580 |
| Director of Heritage Programs | 12 | \$50,808 | \$12,702 | \$63,510 |
| Director of Mariachi Youth Programs | 12 | \$43,965 | \$14,948 | \$58,913 |
| Director of Special Events (Facilities Rentals Manager) | 12 | \$41,687 | \$14,174 | \$55,861 |
| Facilities Evening Supervisor | 12 | \$24,155 | \$8,454 | \$32,609 |
| Los Lupenos Artistic Director | 12 | \$10,000 | \$0 | \$10,000 |
| Mariachi Education Program Coordinator | 8 | \$30,024 | \$10,208 | \$40,232 |
| Operations Manager | 12 | \$60,993 | \$21,347 | \$82,340 |
| Theater Technical Director | 12 | \$44,380 | \$15,089 | \$59,469 |
| Consultants | Total | \$469,138 | \$119,269 | \$588,407 |
| CFO and Accounting Manger *2 | 10 | \$62,850 | \$0 | \$62,850 |
| Receptionist / Assistant to the CEO | 12 | \$43,492 | \$0 | \$43,492 |
| | Total | \$106,342 | \$0 | \$106,342 |
| Total Staff and Consulting Salaries & Benefits Expense | Grand Total | \$575,481 | \$119,269 | \$694,749 |

* 1. Salary includes a \$10,000 bonus. (The Trustees approved a bonus of \$32,000 "paid upon the completion of certain agreed-upon revenue and mission-related objectives" according to MHC. The CEO stated the Executive Committee approved a plan to pay this bonus in increments. The CEO will "approach the board about payment of the rest of approved bonus when, in her estimation and that of the CFO, the organization's cash flow would permit payment of the bonus.")

* 2. MHC's comment on the CEO's salary; "For the first half of Fiscal Year 2007 (July 2006 – December 2006), she was paid at \$105,000, for the second half (January 2007 – June 2007), at \$150,000. Therefore, the amount she was actually paid in that fiscal year is essentially an average of the two salaries: \$128,994. Added to this, we also have the \$10,000 bonus, which would bring the total to \$138,994."

*² The firm billing for the consultant's fees does not separate the cost of the two positions.

Data supplied by MHC



| FYE 2008 Budgeted Staff Salary & Benefits Expense | | | | |
|---|----------------|----------------------|----------------|---------------|
| (Includes Consultants) | | | | |
| | # of | | | |
| | Months on | | | Total Salary |
| Position | Staff | Salary | Benefits | and Benefits |
| Accounting Clerk * | 12 | \$31,200 | \$3,744 | \$34,944 |
| Custodian | 12 | \$24,960 | \$9,984 | \$34,944 |
| Customer Relations Associate and Assistant to the CEO *2 | 12 | \$39,520 | \$7,904 | \$47,424 |
| Director of Mariachi Youth Programs | 12 | \$46,800 \$70,000 | \$5,616 | \$52,416 |
| Director of Operations *3 | 12 | | \$11,200 | \$81,200 |
| Facilities Evening Supervisor | 12 | \$20,800 | \$4,784 | \$25,584 |
| Facilities Maintenance Manger | 12 | \$72,000 | \$25,920 | \$97,920 |
| Facilities Rentals Associate | 12 | \$33,280 | \$4,659 | \$37,939 |
| Facilities Rentals Manager | 12 | \$55,328 | \$11,066 | \$66,394 |
| Fund Development Director | 12 | \$51,500 | \$10,815 | \$62,315 |
| Los Lupenos Artistic Director | 12 | \$13,000 | \$4,420 | \$17,420 |
| Mariachi Education Program Coordinator | 12 | \$49,920 | \$10,483 | \$60,403 |
| President, CEO, and Executive Producer | 12 | \$150,000 | \$15,000 | \$165,000 |
| Theater Technical Director | 12 | \$45,032 | \$13,960 | \$58,992 |
| | Total | \$703,340 | \$139,555 | \$842,895 |
| Consultants | | | | |
| CFO and Accounting Manger | 12 | \$77,400 | \$0 | \$77,400 |
| | Total | \$77,400 | \$0 | \$77,400 |
| | | | | |
| Tatal Staff and Consulting Salarian & Danafite Furnance | Grand | ¢700 740 | ¢120 EEE | ¢020.205 |
| Total Staff and Consulting Salaries & Benefits Expense | Total | \$780,740 | \$139,555 | \$920,295 |
| | | | | |
| Positions include the following title changes: | | | | |
| CEO to President, CEO, and Executive Producer | | | | |
| Receptionist / Assistant to the CEO to Customer Relations | Associate and | Assistant to t | he CEO | |
| Director of Special Events to Facilities Rentals Manager | | | | |
| Facilities Rentals Assistant to Facilities Rentals Associate | | | | |
| Operations Manager to Facilities Maintenance Manager | | | | |
| Accounting Assistant <i>to</i> Accounting Clerk | | | | |
| Notes | | | | |
| | 1.1.1 | | | 771 1 |
| * This position was budgeted for full time, however, the indiv | | ntly only work | ting half time | . This salary |
| & benefit data assumes that the individual is working full time | 2. | | | |
| *2 This individual was a temporary worker for the first two m | onthe of the t | year. Salary & | Benefit amou | unts reflect |
| This individual was a temporary worker for the first two in | onuis or the y | | | |
| - · · | onuis of the y | | | |
| the hiring on July 1. | | | s not been ch | anged. |
| - · · | | | s not been ch | anged. |

A note about salaries and benefits:

1. The CEO stated that historically MHC "provided ad-hoc bonuses as rewards for a job well done in specific circumstances" but we were not provided with the names of staff or positions who received these bonuses, bonus amounts, or the years in which they were



awarded. We can only assume that the information is contained in the salaries and benefit information that MHC provided to us.

2. MHC has informed us that they are "in conversation with selected staff about creating incentive compensation for them"; however, those discussions have not been finalized. We have not been privy to any information about the bonus plan; how it would be established, budgeted and paid for, or the criteria used to establish the award(s). The only formal bonus plan approved by the Board of Trustees is for the current CEO, which is outlined in the FYE2007 Staff Salaries and Benefits chart footnotes.

Detailed Data for Scenarios Outlined by Strategic Philanthropy Advisors, LLC and MHC

We have prepared several charts with in-depth salary and benefit costs for each staff position for the last five years that totals the personnel costs listed in our summary charts in the Scenarios section.

The following chart outlines the historical salary and benefit costs for four positions that we have outlined as "Basic Staff Costs"; minimum staff required to keep the doors of the Plaza open, clean, and serviceable by the public, including the 500-seat theater, which requires specific expertise needed to operate this venue.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years | | | |
|---|-----------|-----------|-----------|-----------|-----------|-----------------------|--|--|--|
| Custodian * | \$20,070 | \$20,534 | \$8,661 | \$22,928 | \$32,580 | \$104,773 | | | |
| Facilities Evening Supervisor | \$13,838 | \$41,337 | \$44,933 | \$39,191 | \$32,609 | \$171,908 | | | |
| Theater Technical Director | \$53,914 | \$56,151 | \$58,941 | \$58,590 | \$59,469 | \$287,065 | | | |
| Director of Operations/Operations Manager * ² | \$64,908 | \$66,202 | \$70,486 | \$74,808 | \$82,340 | \$358,744 | | | |
| Total | \$152,730 | \$184,224 | \$183,021 | \$195,517 | \$206,998 | \$922,490 | | | |
| * One person held the position from FYE 2003 to 2005 and another individual holds the position currently. The data has been combined for the 5-year totals. | | | | | | | | | |

*2 The different titles for the same position (responsibility) have been combined. *Data supplied by MHC*

We have also created a chart containing the staff positions that comprise "Basic Staff Costs" with personnel from the Facilities Rentals Department. In our opinion, these are the staff positions under the current operating model in place at the Plaza that should be allocated to a "Plaza Program budget.

| "Basic Staff Costs" plus Facilities | Rental | | | | | |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------------------|
| Department | | | | | | |
| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
| Custodian | - | - | - | \$22,928 | \$32,580 | \$55,508 |
| Custodian | \$20,070 | \$20,534 | \$8,661 | - | - | \$49,265 |
| Facilities Evening Supervisor | \$13,838 | \$41,337 | \$44,933 | \$39,191 | \$32,609 | \$171,908 |
| Theater Technical Director | \$53,914 | \$56,151 | \$58,941 | \$58,590 | \$59,469 | \$287,065 |
| Facilities Rental Assistant | \$45,414 | \$47,369 | \$20,374 | - | - | \$113,157 |
| Facilities Rentals Assistant | - | \$33,969 | \$9,176 | - | - | \$43,145 |
| Facilities Rentals Assistant | \$14,339 | - | - | - | - | \$14,339 |
| Facilities Rentals Department | \$6,231 | \$60,000 | \$6,923 | - | - | \$73,154 |
| Director of Special Events | - | - | - | \$26,470 | \$55,861 | \$82,331 |
| Director of Operations | \$64,908 | - | - | - | - | \$64,908 |
| Operations Manager | - | \$66,202 | \$70,486 | \$74,808 | \$82,340 | \$293,836 |
| Total | \$218,714 | \$325,562 | \$219,494 | \$221,987 | \$262,859 | \$1,248,616 |

MCH's Requestst the Following Staff Positions Be Paid by the City and Included in Their Annual O&M Subsidy.

Information is from Budgeted 2008 Salaries & Benefits

| | # of Months on | | | Total Salarra |
|---|-------------------|------------|-----------|---------------|
| | | . . | D 7 | Total Salary |
| Staff/Consulting Position | Staff | Salary | Benefits | and Benefits |
| Accounting Clerk | 12 | \$31,200 | \$3,744 | \$34,944 |
| CFO and Accounting Manger | 12 | \$77,400 | \$0 | \$77,400 |
| Custodian | 12 | \$24,960 | \$9,984 | \$34,944 |
| Customer Relations Associate and Assistant to the CEO*2 | 12 | \$39,520 | \$7,904 | \$47,424 |
| Director of Operations | 12 | \$70,000 | \$11,200 | \$81,200 |
| Facilities Evening Supervisor | 12 | \$20,800 | \$4,784 | \$25,584 |
| Facilities Maintenance Manger | 12 | \$72,000 | \$25,920 | \$97,920 |
| Facilities Rentals Associate | 12 | \$33,280 | \$4,659 | \$37,939 |
| Facilities Rentals Manager | 12 | \$55,328 | \$11,066 | \$66,394 |
| President, CEO, and Executive Producer | 12 | \$150,000 | \$15,000 | \$165,000 |
| Theater Technical Director | 12 | \$45,032 | \$13,960 | \$58,992 |
| | Total | \$619,520 | \$108,221 | \$727,741 |

Strategic Philanthropy Advisors



Various Scenarios for the City of San Jose to Consider as it Relates to the Operations and Maintenance Agreement

All of these scenarios occur under the assumption that the City will retain MHC as the operator and programmer of the Plaza. In addition, it assumes that the City will find agreeable the current/future identity and program vision articulated by MHC.

If the City decides that it is in the best interest of the community to change operators or to modify or request changes of MHC's programmatic vision, then these scenarios can only be useful as a starting point for conversations about potential O&M subsidy arrangements. In the latter case, the specificity of the historical figures might not be applicable in determining future financial support.

Scenario 1

Total payments received by MHC under the annual O&M Agreement, including special one-time additional payments for two of the five years, has more than covered the costs to operate and maintain the Plaza for the review period. In fact there has been a surplus of \$790,000 generated that could have been applied to the Reserve Requirement or towards other expenses of MHC's choosing such as programs, equipment, or staff costs.

This scenario also operates under our interpretation of the O&M Agreement that no additional subsidy is required because the City's financial support is only intended to help the operator with some of its operations and maintenance expenses and not 100 percent of its costs. Any shortfall in a given year will need to be raised by the nonprofit organization through outside funders. It also makes an assumption that the City and MHC, as operator of the Plaza, will resume its adherence to the O&M Agreement regarding budget and financial information that the organization is required to present to the City. This means that the organization will be presenting an annual operations and maintenance budget for the facility to the City for approval along with comparisons to the actual costs to operate the facility in the prior year.



| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|--------------------------------------|-----------|-----------|-----------|-----------|-----------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$2,258,397 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| Difference without staff costs | \$99,094 | \$102,033 | \$159,437 | \$113,362 | \$316,155 | \$790,080 |

Scenario 2

When the salaries and benefits of the staff who have direct responsibility for keeping the facility clean, maintained, or are responsible for overseeing the theater and its running its technical systems (Custodian, Facilities Evening Supervisor, Theater Technical Director, and Director of Operations/Operations Manger) are added to the Consultant-calculated O&M expenses, the calculation of the total annual costs incurred by MHC increases.

If the City wants to provide an annual O&M subsidy to cover 100 percent of the operations and maintenance costs plus "Basic Staff Costs" then future O&M subsidies will need to be increased based on our analysis of historical data.

Based on budgeted FYE2008 staff salary and benefit costs, the "Basic Staff Costs" scenario would cost \$217,440 plus actual operations and maintenance cost that have averaged \$294,000 for the last five years. This would mean that the FYE2008 O&M subsidy would need to total approximately \$511,000 for this year, which is an increase of almost \$98,000 over the annual O&M subsidy of \$413,783 outlined in the O&M Agreement.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|---|-----------|-----------|-----------|-----------|-----------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$2,258,397 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| Basic Staff Costs (Salaries & Benefits) | \$152,730 | \$184,224 | \$183,021 | \$195,517 | \$206,998 | \$922,490 |
| Difference | -\$53,636 | -\$82,191 | -\$23,584 | -\$82,155 | \$109,157 | -\$132,410 |

Scenario 3

An additional scenario for the City to consider is to cover 100 percent of the operations and maintenance costs of the Plaza along with "Basic Staff Costs" salaries and benefits as well as a percentage of the MHC's indirect costs. This would acknowledge that Best Practices for nonprofit budgets allocate a percentage of administrative, general, and fundraising costs to all programs. In the case of MHC, this would mean that a percentage of the CEO, CFO and accounting staff, Director of Operations (who is senior staff and oversees the facilities rentals and facilities maintenance departments, is involved in Human Resources, and programs) and any current or future fundraising and marketing staffs' salaries and benefits be allocated *amongst all* of MHC's programs including the Plaza Program, which we believe has two components: facilities and rentals.

Unfortunately we are not able to provide historical information as to how much this scenario would have cost the City each year if the scenario had been in place starting in FYE2003. MHC never created program budgets and only tracked expenses by department. Even the latter data is not



consistent because there were limited income and expense allocation procedures in place. As a result it is difficult to determine how or why specific items were allocated to each department. In some years expenses were allocated or shared amongst all departments and in other years similar costs were only allocated to "Administration".

While the organization incurs administrative/general expenses, in our view "Administration" is a department and not a program. While the allocation of expenses by department is a common book keeping tool, allocation by programs is a beneficial tool for organizational budgeting as the process is based on realistic support/revenue projections and not expenses. In fact foundations and other funders request program budgets when nonprofit organizations apply to them for grants and support.

We analyzed MHC's proposed FYE2008 budget that it will be presenting to the Board of Trustees in January for approval as another way to calculate a range as to how much this scenario might cost the City for this fiscal year. Again, MHC has not been consistent in the manner in which it created all of its program budgets. Administration, Marketing and Fundraising are listed as program budgets, which mean that these costs have not been allocated amongst all of its actual programs that it is now calling Music Education, Visual Arts, Performing Arts, Los Lupeños, and Mariachi Festival. Every program, with the exception of the Mariachi Festival, has staff salaries and benefits allocated to them. Clearly this program requires a great deal of staff time, including that of the CEO who also serves as Executive Producer of the event, in order to produce the two-day festival and related workshops.

We would further recommend that MHC allocate some of the Mariachi Youth Education program staff to the Mariachi program in addition to the CEO and accounting staff since youth education workshops are part of the festival's offerings. As part of this process, the youth education budgets would be reduced by the corresponding amount of staff salaries reallocated to the Mariachi Festival.

We understand that allocating these staff expenses as well as a percentage of the organization's indirect expenses will reduce the projected income that this festival is budgeted to produce. In fact, because the organization has never produced program budgets it can only guess at which programs (MHC Presents, youth education, Mariachi, Gallery etc.) are profitable and by how much, and which programs might have cost the organization a great deal more to run than it had expected.

At the end of the day, cash rules and all nonprofit organizations have to raise funds or generate income to pay for general operating expenses that include staff costs in order to balance its books. This is why we have presented this scenario because we are mindful that there are a great deal of indirect costs associated with operating and maintaining the Plaza. We might suggest that a sum between 15 to 35 percent of indirect costs would be an appropriate amount to be added to the annual O&M subsidy for these indirect costs along with the computed salaries and benefits that make up "Basic Staff Costs." This subsidy amount would have to be determined after a revised program budget is developed and approved by both MHC's Board of Trustees and the City.



Scenario 4

The staff positions listed under this scenario relate to the current operating model in place at the Plaza that should be allocated to a Plaza Program budget. These positions are "Basic Staff Costs" as well as the staff that comprise the Facilities Rentals Department.

This scenario, in our opinion, only makes sense if the City feels that in addition to paying for 100 percent of the operations and maintenance costs as well as "Basic Staff Costs", it should also fund staff position that make the facility available to the public as well as to MHC for its own programming through its MHC Presents.

This scenario is a bit different from the previous one in that no indirect costs have been added to it. We note that this scenario does not take into account the rental income generated by the Plaza that offsets "Basic Staff Costs" as well as Facilities Rentals Staff Costs.

| | FYE 2003 | FYE 2004 | FYE 2005 | FYE 2006 | FYE 2007 | Totals 5-Years |
|---|------------|------------|-----------|------------|-----------|----------------|
| City O&M Agreement Subsidy | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$413,783 | \$2,068,915 |
| City One-Time Cost of Living Subsidy | \$14,482 | - | - | - | - | \$14,482 |
| City One-Time Additional Funding | - | - | - | - | \$175,000 | \$175,000 |
| Total City O&M Payments Received | \$428,265 | \$413,783 | \$413,783 | \$413,783 | \$588,783 | \$1,468,317 |
| Consultant-calculated O&M Expenses | \$329,171 | \$311,750 | \$254,346 | \$300,421 | \$272,628 | \$1,468,317 |
| "Basic Staff Costs" + Facilities Rentals Staff Costs (Salaries & Benefits) | \$218,714 | \$325,562 | \$219,494 | \$221,987 | \$262,859 | \$1,248,616 |
| Difference | -\$119,620 | -\$223,529 | -\$60,057 | -\$108,625 | \$53,296 | -\$458,536 |



Mexican Heritage Corporation's Financial Requests to the City of San Jose as Operators and Programmers of the Plaza

We asked MHC to provide us in writing what amount it believes the City should be providing it annually as an O&M subsidy in its role as operator and programmer of the Plaza. We also asked the CEO to outline the organization's other financial requests for consideration by the City so that it can correct what it considers to be a major issue: its under capitalization and lack of financial support from the City since the facility opened and the organization became its operator and programmer.

We have added several comments to this section as well in italic.

- 1. MHC is requesting a \$1.3 million annual O&M subsidy from the City to pay for operations and maintenance costs for the Plaza as well as to cover 100 percent of the following staff costs (in alphabetical order):
 - Accounting Clerk
 - Accounting Manager
 - CFO
 - Custodian
 - Customer Relations Associate and Assistant to the CEO
 - Director of Operations
 - Facilities Evening Supervisor
 - Facilities Maintenance Manger
 - Facilities Rentals Associate
 - Facilities Rentals Manager
 - President, CEO, and Executive Producer
 - Theater Technical Director

According to MHC, the annual O&M payment is not intended to be "static" and having it paid either quarterly or monthly by the City is acceptable. MHC's CEO provided the Consultants and the City with the following related statement:

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"We assume that, in the event that the City Council approves our continuation as operator of the Plaza, we will then enter into negotiations with the City Manager on a new contract. At this point, we would expect to negotiate an appropriate cost of living increase to the annual payment, as well as potential bonuses paid upon completion of agreed-upon targets and milestones. We would look to the City's facilities contract with Team San Jose or the Sharks for guidance on the form those earned revenue objectives might take, but at the same time it will be important to remember that our objectives must be synergistic with our status as a not-for-profit arts programmer, while Team San Jose and the Sharks organizations are venue operators and a sports and entertainment company. We need to be able to maintain an appropriate balance between our role as a programmer and our role as an operator."

2. We asked for further clarification for examples of the "revenue objectives" or "targets" and we received the following response from MHC's CEO:

"We would need to explore this further with the City but the following come to mind at present - payment of bonuses for the following target areas:

- Creating new savings in energy usage
- Creating new incentives re "green" use of the venue that reduce waste, improve re-cycling, etc.
- Increasing local/regional/national partnerships to deliver arts programming that is high in artistic and production/education value but delivers the program with greater efficiency and less cost
- Increasing revenue through social venture/entrepreneurial activities that are synergistic to our arts mission such as implementation of food service or restaurant concession with a local restaurateur
- Agree on a goal to raise money by monetizing naming of physical spaces at the venue"
- 3. Forgiveness of the remaining balance on the \$650,000 zero-interest loan made to MHC in 2000. Currently the organization has repaid \$150,000 of loan and there is an outstanding balance remaining of \$500,000. In addition, MHC wants to be reimbursed by the City for the \$150,000 that it has paid on the loan balance.

It is not clear to us if the forgiveness of this loan and repayment of principal is a stand alone request or tied to the recent \$1,000,000 State of California that the organization received to make capital improvements to the Plaza. This grant request was submitted to the State with the Redevelopment Agency and funding was received that was spent on upgrades to the HVAC system, landscaping and other areas of the facility. Because we have not seen the full list of capital improvements, we were not able to compare them to the unit replacement responsibility list in the OCM Maintenance Matrix. We are making the assumption that MHC is requesting compensation from the City for overseeing the improvement in the facility and/or because the City would have been responsible for paying for these unit replacements. We note, however, that the Redevelopment Agency worked closely with MHC on all aspects of this project and the City did not have to pay for any of these capital improvements out of the City's budget.

4. MHC believes that it has "subsidized" the Resident Art Partners by providing below market office rents as well as facility rental charges for the use of the Plaza's various venues and



classroom space. According the MHC, they are requesting; "Compensation for the eight years of past subsidy MHC has provided to the RAP program." We were directed to the June 5, 2006 letter that the CEO sent to the former City Manager.

In this document, MHC states; "it looses a minimum of \$300,000 [a] year — \$100,000 in lost earned income as a result of the lower-than-market rental rates it is obligated to charge the Resident Arts Partners for the use of the theater facilities and another approximate \$200,000 in lost revenues due to production, programming, and earned revenue opportunities arising out of scheduling conflicts with Resident Art Partners programming. These costs, combined with expenses associated with RAP use of the facility, the rising energy costs associated with general facilities maintenance, as well as management and fund development set backs experienced in the Plaza's formative years, significantly contributed to MHC's existing financial deficit."

In more recent email correspondence with the Consultants, MHC calculated that the RAPs had cost them \$60,000 last year over what they had paid in rental fees if facility staff costs had been added to the facility rental charges.

In summation of these financial requests to the City, the CEO stated the following; "These amounts, in addition to the annual subsidy would provide an appropriate re-capitalization of MHC and a sound financial base to move forward. We believe, and we would ask that you communicate this in your report, that the City would likely need to entertain providing similar economic incentives to any third party venue operator who would assess the financial cost of maintenance and operations of the Plaza on a de novo basis."

Appendix 3:

Documents Reviewed For Financial and Operating Capacity Assessment

Legal Documents

- ✓ City of San Jose-Memorandum: "Naming the Mexican Heritage Plaza" dates 8/4/1999, which includes a City of San Jose Naming of City-Owned Facilities Nomination Form
- ✓ California's Nonprofit Integrity Act (California Senate Bill No. 1262) also known as the Nonprofit Integrity Act, which was passed in the latter part of 2004
- ✓ By-Laws of the Mexican Heritage Corporation of San Jose, adopted June 26, 1997
- ✓ Articles of Incorporation of Mexican Heritage Corporation, April 27, 1988
- ✓ Internal Revenue Service 501(c)(3) tax-exempt determination letter
- ✓ Operation and Maintenance Agreement Between the City of San Jose and the Mexican Heritage Corporation for the Mexican Cultural Heritage Gardens Facilities, San Jose, California, March 7, 1996
- ✓ Fifth Amendment to Agreement Between the City of San Jose and the Mexican Heritage Corporation for the Operation and Maintenance of Mexican Heritage Plaza – Centro Cultural de San Jose (Formerly the Mexican Cultural Heritage Gardens), June 11, 2007
- ✓ Board of Director Minutes from meetings held May through December 2007
- ✓ Mexican Heritage Corporation Loan Agreement with the City of San Jose and the First, Second, and Third Amendments
- ✓ Resident Arts Program Operating Agreement and Operating Procedures Handbook, July 2001
- ✓ Contract Rider Theater Guidelines and Restrictions for the Plaza Theater

Human Resource-Related

- ✓ Employee Handbook issued July 2006 by MHC and prepared by Your People Professionals
- ✓ Employee Handbook Addendum issued July 2006 by MHC and prepared by Your People Professionals
- ✓ Injury and Illness Prevention Program Handbook
- ✓ Job descriptions for the following positions: Development Manager, Maintenance Director,
- ✓ Resumes/bios for the following staff: CEO, Director of Mariachi Youth Education
- ✓ Staff Organizational Charts: FYE2006 and Proposed for FYE2007 and FYE2008

Financial Documents

- ✓ Audited Financial Statements for Fiscal Years Ended 1999 to 2006
- ✓ Consolidated Profit and Loss Statements for Fiscal Years Ended 2001 to 2007 and for FYE2008 to December 31, 2007
- ✓ Profit and Loss Statements by Department for Fiscal Years Ended 2001 to 2007
- ✓ Projected Revenue Expense Statement By Department FY 07-08
- Mexican Heritage Corporation Statement of Revenues and Expenditures for FYE2008 through 12/31/2007
- ✓ Selected General Ledger Line Items for Fiscal Years Ended 2001 to 2007
- Revenue and Expense Statements (Approved Budget versus Actuals) for the following months in FYE2008: July 2007 to December 2007
- ✓ Mexican Heritage Corporation Balance Sheet as of November 30, 2007



- ✓ MHC Revenue Expense Statement for OCA Report as of June 30, 2007
- ✓ Draft Marketing Department Budget July 17, 2007
- ✓ 2007 Mariachi Festival Budget
- ✓ 2007 Mariachi Festival Revenue and Expense Statement
- ✓ Cash Flow Profile July 2006 to June 2007
- ✓ Projected Budget Outlook July 2007 to June 2008
- Mexican Heritage Corporation Projected Revenue Expense Statement By Department FYE2008
- ✓ FYE2009 Program Budgets
- ✓ Monthly Bank Statements for FYE2008 from July 1 to December 31, 2007
- ✓ IRS Form 990s for the following years: 2000 to 2005
- ✓ RAP versus Regular Non-Profit rate comparison
- ✓ Fiscal Year 06/07 Actual Expenses (Plaza), Square Footage Calculations and Salaries Spreadsheet (MHC data – not dated)
- ✓ Mexican Heritage Corporation Statement of Functional Expenses for the Year Ended June 30, 2006
- ✓ Mexican Heritage Corporation Preliminary Plan Fiscal Year 2006-2007

Other Miscellaneous Documents

- ✓ Emails to/from the City and MHC regarding naming rights
- ✓ Mexican Heritage Plaza Artistic Vision Statement and Program Structure, January 30, 2006
- ✓ Case Statement San Jose's Mexican Heritage Plaza: Arts-Based Community Development, April 2004
- ✓ Office of the City of San Jose's Auditor: 'A Review of the Mexican Heritage Corporations' Ability to Operate and Maintain the Mexican Heritage Plaza (March 2007)
- ✓ Various correspondence and interview notes in the City Auditor's files related to its audit of Mexican Heritage Corporation in 2007
- ✓ City of San Jose Operating Grant Program FYE2005-06 Grantee Final Report
- ✓ List of Board of Trustees (name, board position, title and company affiliation, date joined board, home zip code and board committee membership) provided by MHC
- ✓ Mexican Heritage Plaza Artistic Vision Statement and Program Structure, January 30, 2006
- ✓ Grant Agreement: Destination Event Marketing Grant Agreement Between The City of San José And Mexican Heritage Corporation of San Jose, 2007
- ✓ Mexican Heritage Corporation Business Plan, March 2007
- ✓ MHC Major Gifts Prospect List (2007-2008)
- ✓ MHC Grant Requests FYE2007
- ✓ MHC Grant Requests FYE2008
- ✓ Discussion Draft Development Budget 2007/08
- ✓ MHC Corporate Sponsorship Support for the 2006 and 2007 Mariachi Festival
- ✓ Mexican Heritage Corporation Long-Range Fund Development Strategy 199-2003
- ✓ Business Plan for the Mexican Heritage Corporation, October 25, 2000
- ✓ Mexican Heritage Corporation Strategic Plan 1998 2003
- ✓ The Mexican Heritage Plaza: Tactical Planning Retreat Envisioning 2003/04 (June/July 2003) Notebook
- ✓ Mexican Heritage Plaza: Assessment of Fund Raising Program, September 28, 2005

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- ✓ Packard Foundation Grant Proposal submitted by MHC on April 7, 2006
- ✓ San Francisco Bay Area Spanish Media Guide, Univision Radio
- ✓ Mexican Heritage Plaza FYE2003/04 Development Plan
- ✓ Fund Development Outline Plan 06-07 Working Draft
- ✓ Donor Research Project: Latino Philanthropy Literature Review (2003)
- ✓ MHC list of Programmatic Accomplishments 2005-2007
- ✓ Several MHC Staff Organizational Charts (actual document dates not reference) for FYEs 2005 to 2008 (many were hypothetical and not actual)
- Draft Report for Maintenance Oversight Services Mexican Heritage Plaza, January 31, 2001
- ✓ Aztec Consultations report on HVAC at Mexican Heritage Plaza, December 21, 2001
- ✓ An Operational Plan for the Mexican Cultural Heritage Gardens in San Jose, California, May 1995 by the Wolf Organization
- ✓ Response by MHC to Consultant's Reports (January 16, 2008)