HEROES INC
Form 10QSB/A
December 14, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB/A

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from________ to___________.

Commission File No. 0-12597

HEROES, INC.
(Exact name of registrant as specified in its charter)

Nevada	11-1843262
(State of Incorporation)	(I.R.S. Employer Identification No.)

1915 - B Chain Bridge Road, Suite 506, McLean, Virginia 22102
(Address of principal executive offices)

(703) 761-1900
(Registrant's telephone number, including area code)

1980 Gallows Road, Suite 200, Vienna, Virginia 22182
(Former name, former address and former fiscal year, if changed since last report)

Check whether the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by court.

Yes[ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, $0.001 par value per share, 99,213,109 shares issued and outstanding as of December 14, 2001.

Transitional Small Business Disclosure Format (check one):
YES [ ] NO [X]

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PART 1

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HEROES, INC.

BALANCE SHEETS
(UNAUDITED)

ASSETS

	September 30, 2001 (unaudited)	December 31, 2000
CURRENT ASSETS:		
Cash and cash equivalents	$ -	$ 70,268
Accounts receivable	8,859,617	8,859,617
Other receivables	26,596	36,145
Employee advances	16,811	5,025
Refundable deposits	--	46,572
Prepaid maintenance and training costs	46,418	318,585
Other current assets	48,222	48,222
Total Current Assets	8,997,664	9,384,434
EQUIPMENT, less accumulated depreciation of $15,765 at September 30, 2001 and $9,465 at December 31, 2000	595,824	269,669
OTHER ASSETS:		
Other assets	100	100
Prepaid maintenance and training costs - long-term	--	191,997
Total Other Assets	100	192,097
Total Assets	$9,593,588	$9,846,200

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

HEROES, INC.

BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' DEFICIT

	September 30, 2001	December 31, 2000
CURRENT LIABILITIES:		
Bank overdraft	$ 204	$ --
Line of credit, including accrued interest	3,593,337	3,131,190
Accounts payable and accrued expenses	7,514,468	7,025,958
Employee accounts payable	53,241	56,934
Accrued compensation	375,951	185,174
Notes payable, including accrued interest	1,177,895	--
Deferred maintenance and training revenue	--	224,000
Total Current Liabilities	12,715,096	10,623,256
DEFERRED MAINTENANCE AND TRAINING REVENUE - LONG-TERM	--	191,997
Total Liabilities	12,715,096	10,815,253
STOCKHOLDERS' DEFICIT:		
Common stock, 500 million shares and 100 million shares authorized, as of September 30, 2001 and December 31, 2000, respectively; $.001 par value, 91,213,109 shares issued and outstanding at September 30, 2001; 35,840,246 shares issued and outstanding at December 31, 2000	91,213	35,840
Paid-in capital	6,023,076	4,646,253
Accumulated deficit	(9,235,797)	(5,651,146)
Total Stockholders' Deficit	(3,121,508)	(969,053)
Total Liabilities and Stockholders' Deficit	$ 9,593,588	$ 9,846,200

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

HEROES, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30, 2001	Three Months Ended September 30, 2000	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
Revenues	$ --	$ 61,000	$ --	$ 6,376,017
Direct Costs	--	137,335	55,291	6,211,671
Gross Profit (Loss)	--	(76,335)	(55,291)	164,346
Operating Expenses:				
General and Administrative expenses	240,486	81,471	1,527,954	306,281
Consulting and professional fees	21,055	263,048	704,933	404,818
Salaries and wages	243,732	191,879	1,296,472	526,796
Total Operating Expenses	505,273	536,398	3,529,359	1,237,895
LOSS BEFORE PROVISION FOR INCOME TAXES	(505,273)	(612,733)	(3,584,650)	(1,073,549)
PROVISION FOR INCOME TAXES	--	--	--	--
NET LOSS INCOME	$(505,273)	$(612,733)	$(3,584,650)	$(1,073,549)
NET LOSS PER SHARE:				
Basic	$ (0.01)	$ (0.02)	$ (0.06)	$ (0.03)
SHARES USED IN COMPUTING EARNINGS PER SHARE:				
Basic	75,285,000	32,925,000	64,032,000	32,925,000

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

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HEROES, INC.

STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months September 30, 2001	2000
Net loss	$(3,584,650)	$(1,073,549)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization	-	45,833
Depreciation	6,300	6,300
Forfeited security deposit	46,572	-
Issuance of common stock for compensation & expenses	602,196	5,000
(Increase) decrease in assets:		
Accounts receivable	-	(5,016,693)
Other receivables	9,549	-
Other current assets	-	(227,841)
Employee advances	(11,786)	-
Prepaid maintenance costs	464,164	168,999
Other assets	-	(9,185)
Increase (decrease) in liabilities:		
Bank overdraft	204	-
Accounts payable and accrued expenses	488,509	2,054,138
Line of credit accrued interest	462,147	-
Note payable accrued interest	22,103	-
Employee accounts payable	(3,693)	-
Accrued compensation	190,777	-
Deferred maintenance and training revenues	(415,997)	(168,000)
Net Cash Used in Operating Activities	$(1,723,605)	$(4,214,998)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loan to Children's Hero's, Inc.	-	(320,100)
Investment in Sanswire.net, LLC	-	(200,000)
Acquisition of equipment	(332,455)	(34,485)
Net Cash Used In Investing Activities	(332,455)	(554,585)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Receipt of escrow deposit	-	205,000
Proceeds from issuance of common stock	830,000	1,602,617
Cash received for note payable to stockholder	1,155,792	250,000
Net change in line of credit	-	2,871,114
Net Cash Provided By Financing Activities	1,985,792	4,928,731
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(70,268)	159,148
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	70,268	100
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ -	$ 159,248

NONCASH INVESTING AND FINANCING TRANSACTIONS

During the nine months ended September 30, 2000, the Company issued 4.5 million shares of common stock for a subscription receivable of $2 million.

During the nine months ended September 30, 2000, a $250,000 note payable to stockholder was converted to 500 shares of Spherus common stock prior to the merger.

During the nine months ended September 30, 2000, the Company issued 50,000 shares of common stock for services at $.10 per share.

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

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NOTE A - FORMATION AND OPERATIONS OF THE COMPANY

Heroes, Inc. ("we", "us", "our") was incorporated under the laws of the state of Nevada, and is in the business of providing turnkey installations of an internet-based video distribution and multimedia network to school districts primarily in metropolitan Atlanta, Savanna and Brunswick, Georgia. On December 7, 2000, we changed our name from Penn-Akron Corporation to Heroes, Inc.

Use of Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. The reported amounts of revenues and expenses during the reporting period may be affected by the estimates and assumptions we are required to make. Actual results could differ from those estimates.

Basis of Presentation

Our accompanying unaudited statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-QSB and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2001 are not necessarily indicative of the results for the year ending December 31, 2001. The accompanying financial statements and notes thereto should be read in conjunction with our audited financial statements as of December 31, 2000 and 1999 contained in our current Annual Report on Form 10-KSB.

NOTE B - GOING CONCERN

On December 4, 2001, we have filed for protection under Chapter 11 of the Bankruptcy Code. The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. We have an accumulated deficit of approximately $9,235,797 through September 2001, and anticipate incurring net losses for the foreseeable future and will require a significant amount of capital to commence our planned principal operations and proceed with our business plan. Accordingly, our ability to continue as a going concern is dependent upon our ability to secure an adequate amount of capital, through either additional equity funding or loans with appropriate repayment terms, to finance our planned principal operations and/or implement our business plan. Our major plan is to devote appropriate resources to obtain a quick and favorable resolution of the matters related to our MRESAnet 2000 Project. We recognize that additional working capital will be required for us to be successful in achieving these goals. These factors, among others, may indicate that we will be unable to continue as a going concern for a reasonable period of time.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

NOTE C - COMMON STOCK

On January 10, 2001, we issued a private placement memorandum at an offering price of $.25 per unit. Each unit consists of one share of common stock, and one warrant. The warrants entitle the holders to purchase one share of common stock for each warrant held at an exercise price of $.50 per share until January 15, 2004. As of September 30, 2001, 3,320,000 units have been sold for $830,000.

We also issued 800,000 warrants for consulting services which entitles the holders to purchase one share of common stock for each warrant held at exercise prices ranging from $.40 - $.50 per share vesting in 4 - 24 months.

During the nine months ended September 30, 2001, 900,000 options to purchase common stock expired due to the termination of two employees. In addition, during that period we issued approximately 52,000,000 shares to employees and consultants for compensation and reimbursement of operating expenses.

On September 24, 2001, we filed a certificate of amendment to our Articles of Incorporation to increase the number of authorized shares from 100,000,000 to 500,000,000.

NOTE D - OPERATING LEASES

We terminated our lease for office space and forfeited the $46,572 deposit. No new lease has been signed.

NOTE E - NOTES PAYABLE

We issued three promissory notes for a total of $1,155,792 received from three current investors. These notes accrue interest at 10% per annum and are due on demand, but no later than November 23, 2001. The note holder has the option to convert all or a portion of the note into shares of our common stock at $.01 per share. If we plan to payoff all or part of the principal amount, we shall give the note holder 20 days notice of our intention. During this 20-day period, the note holder may elect to convert the amount to be paid by us into shares at the Conversion Price.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Liquidity And Capital Resources

On December 4, 2001, we filed for protection under chapter 11 of the Bankruptcy Code. We intend to describe such filing in greater detail in a Current Report in Form 8-K to be filed in accordance with the applicable rules.

As of September 30, 2001, we had no cash, a working capital deficit of approximately $3.7 million and a stockholders deficit of approximately $3.1 million. These deficits continue to increase while we develop and market our products. We have paid certain expenses and notes through the issuance of common stock. Our continuation as a going concern is dependent upon our ability to obtain additional working capital. If adequate financing is not available or is not available on acceptable terms, our ability to meet our capital requirements may be significantly limited and could have a material adverse effect on us and ultimately could impair our ability to continue as a going concern.

Results of Operations

Our revenues decreased to $0 for the nine-month period ending September 30, 2001 from $6,376,017 for the nine-month period ending September 30, 2000. This decrease is primarily due to the fact that no invoices for additional work to be performed in Year 2 of our three-year contract with our current customer, the Metropolitan Regional Educational Service Agency ("MRESA"), have been submitted, pending the outcome of an audit of MRESA by Arthur Andersen, LLP, and the determination by both the Federal Communications Commission ("FCC") and the Schools and Library Division ("SLD")as to whether or not the MRESA project shall continue, and under what terms and conditions.

Our current customer is MRESA, an administrative services agency of the Georgia Department of Education. The MRESA jurisdiction covers over 11 school districts, and nearly 750 schools. Our contract with MRESA was executed in March 1999, and we began performance thereunder in August 1999. This contract continues for a three-year period. As of December 31, 1999, we had completed Year 1 of the three Years under this contract and installed our services at 192 schools. All invoices and installations for Year 1 were approved by MRESA. We began performance on Year 2 of our contract with MRESA in early May 2000. Lynxus, Inc. ("Lynxus"), our main contractor at that time, was responsible for all performance under the contract, including the procurement and installation of all equipment.

We are currently seeking additional customers for our schools deliverable and products, and are seeking to expand into a number of states and school districts within the next 12-24 months.

In August 2000, Arthur Andersen, LLP, began an audit of MRESA. The MRESA contract is funded by the Schools and Libraries Division ("SLD") of the Universal Service Administrative Company. This is a non-profit entity under the jurisdiction of the Federal Communications Commission ("FCC"). The latter administers all "E rate" funds, which were enacted pursuant to the Federal Telecommunications Act of 1996. The program under which the SLD provides funding to MRESA requires a 10% to 50% matching commitment for each school from private, corporate or charitable contributions. The audit is part of an ongoing program integrity process initiated by the SLD to ensure that applicants and vendors (beneficiaries) of the E-rate program comply fully with all FCC and SLD program guidelines, rules and regulations. A number of beneficiaries of the SLD program

are audited annually. The determination of which beneficiaries are audited is done both randomly and based on the size of the beneficiary's award. We, as the service provider of the contract, are also being audited as part of this process. As of the date of this report, we have invoiced a total of $3,595,648 for services performed under our contract for Year 2 of this program to the SLD, with all invoices being approved by MRESA. As of the date of this report, all of that amount remains outstanding and unpaid by the SLD. We have also invoiced MRESA $2,600,735 for Year 2 matching funds which also remains outstanding as of the date of this report. We anticipate that payment from the SLD for past services performed by us will be forthcoming, subject to the approval by both the FCC and the SLD to continue the MRESA project. The total amount of these invoices to the SLD and MRESA for Year 2, as per our agreement, could eventually exceed $12,000,000.

Our total cost of sales decreased to $55,291 for the nine-month period ending September 30, 2001 from $6,211,671 for the same period in 2000. The $55,291 in costs during 2001 were for year 1 maintenance and corrective rework carried out on our behalf by Domain Networks.

General and administrative expenses increased to $1,527,954 for the nine month period ending September 30, 2001 from $306,281 for the same period in 2000 and our salary expense increased to $1,296,472 for the nine month period ending September 30, 2001 from $526,796 for the same period in 2000, primarily due to the addition of staff in preparation of launching the Children's Heroes electronic fundraising program, pursuant to the acquisition of Children's Heroes in October of 2000. Our consulting and professional expenses increased to $704,933 for the nine month period ending September 30, 2001 from $404,818 for the same period in 2000 as a result of the engagement of several consultants to assist the company on working towards resolution on the MRESAnet 2000 project.

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PART II

Item 1. Legal Proceedings.

On May 31, 2001, Mastermind Marketing filed a civil action suit in the State Court of Fulton County, Georgia. On September 19, 2001 Mastermind Marketing was awarded a total of $169,246.41, including interest, for the preparation of presentations, marketing strategies, and other promotional programs and delivered intellectual property and other products, services and expenses. We are currently evaluating whether to appeal this judgment.

Item 2. Changes in Securities.

NONE

Item 3. Defaults upon Senior Securities.

NONE

Item 4. Submission of Matters to a Vote of Security Holders.

NONE

Item 5. Other Information.

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Resignation of Director

Christopher Smith resigned from the Board of Director on September 19, 2001.

Changes in Accountant

On December 10, 2000, we discharged Windham Brannon, P.C. as principal independent accountant. The decision to change principal accountant was due to the fact that we filed a voluntary petition for relief under chapter 11 of the bankruptcy code, and Windham Brannon, P.C., is now a pre-petition creditor.

From the engagement of Windham Brannon, P.C. on July 6, 2000 to their discharge on December 10, 2001, there were no disagreements on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreement, if not solved to their satisfaction, would have caused them to make reference in connection with their opinion to the subject matter of the disagreement.

Windham Brannon, P.C.'s reports on the financial statements of the Company as of and for the year ending December 31, 2000 did not express an opinion due to a significant uncertainty related to the valuation of certain assets and the completeness of certain liabilities. In addition, there was an explanatory paragraph related to our ability to continue as a going concern.

Windham Brannon, P.C.'s reports on the financial statements of the Company as of and for the year ending December 31, 1999 qualified their opinion due the fact that they were unable to confirm a certain receivable and satisfy themselves as to the carrying value of that receivable. In addition, there was an explanatory paragraph related to our ability to continue as a going concern.

We requested that Windham Brannon, P.C. furnish us with a letter addressed to the Securities and Exchange Commission stating whether it agrees with the statements contained in this Report on 10-QSB. A copy of such letter, dated December 14, 2001, is filed as Exhibit 16.1 to this Report on 10-QSB.

On December 14, 2001, our Board of Directors approved the engagement of Kingery, Crouse & Hohl, P.A., as our principal independent accountant. The engagement will begin with our third quarter 2001 financial statements. Through December 14, 2001, neither we nor anyone on our behalf consulted Kingery, Crouse & Hohl, P.A. regarding (i) the application of accounting principles to any transaction, either completed or proposed, or (ii) the type of audit opinion that might be rendered by Kingery, Crouse & Hohl, P.A. on our financial statements.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

16.1 Letter from Windham Brannon, P.C

(b) Reports on Form 8-K.

NONE

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Heroes, Inc.

/s/ Amer A. Mardam-Bey
By: Amer A. Mardam-Bey

(President & CEO)
Date: December 14, 2001

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