

**Classroom, Inc.**

**Financial Statements**

**June 30, 2012 and 2011**

**Independent Auditors' Report**

**The Board of Directors  
Classroom, Inc.**

We have audited the accompanying statements of financial position of the Classroom, Inc. ("CI") as of June 30, 2012 and 2011 and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of CI's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CI's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Classroom, Inc. as of June 30, 2012 and the change in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*O'Connor Davies, LLP*

New York, New York  
October 11, 2012

Classroom, Inc.

Statements of Financial Position

June 30,

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 4,295,601	\$ 3,854,250
Pledges receivable, net	601,431	551,811
Fees and other receivables, net	226,754	918,848
Product inventories	385,998	389,377
Prepaid expenses and other assets	156,310	152,763
Endowment cash equivalent	250,000	250,000
Property and equipment, net	20,795	37,681
Simulation development	278,907	-
	<u>\$ 6,215,796</u>	<u>\$ 6,134,530</u>
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities		
Accounts payable and accrued expenses	\$ 256,953	\$ 218,662
Deferred rent payable	43,163	-
Deferred revenue	30,150	191,095
	<u>330,266</u>	<u>409,757</u>
Net Assets		
Unrestricted		
General	2,775,155	3,076,552
Lacovara Opportunities Fund	686,929	686,929
Board-designated for contingencies	500,000	500,000
Replenishment fund	350,000	350,000
Total Unrestricted	4,312,084	4,613,481
Temporarily restricted	1,323,446	861,292
Permanently restricted	250,000	250,000
Total Net Assets	<u>5,885,530</u>	<u>5,724,773</u>
	<u>\$ 6,215,796</u>	<u>\$ 6,134,530</u>

See notes to financial statements

**Classroom, Inc.**  
**Statements of Activities**  
**Years Ended June 30,**

	2012				2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>SUPPORT AND REVENUE</b>								
Contributions								
Individuals	\$ 247,455	\$ 33,785	\$ -	\$ 281,240	\$ 353,501	\$ 9,800	\$ -	\$ 363,301
Foundations and trusts	1,710,246	1,433,566	-	3,143,812	3,204,595	1,000,165	-	4,204,760
Corporations	29,279	20,000	-	49,279	76,488	45,000	-	121,488
Donated goods and services	89,862	-	-	89,862	93,492	-	-	93,492
Fees	409,401	-	-	409,401	1,021,334	-	-	1,021,334
Interest and dividends	9,820	-	-	9,820	7,226	-	-	7,226
Other revenue	7,213	-	-	7,213	17,842	-	-	17,842
Net assets released from restrictions	1,025,197	(1,025,197)	-	-	851,491	(851,491)	-	-
<b>Total Support and Revenue</b>	<b>3,528,473</b>	<b>462,154</b>	<b>-</b>	<b>3,990,627</b>	<b>5,625,969</b>	<b>203,474</b>	<b>-</b>	<b>5,829,443</b>
<b>EXPENSES</b>								
Educational Programs								
Direct support to schools	1,628,274	-	-	1,628,274	2,082,990	-	-	2,082,990
Curriculum development	826,269	-	-	826,269	557,863	-	-	557,863
Research and assessment	308,051	-	-	308,051	277,645	-	-	277,645
<b>Total Educational Programs</b>	<b>2,762,594</b>	<b>-</b>	<b>-</b>	<b>2,762,594</b>	<b>2,918,518</b>	<b>-</b>	<b>-</b>	<b>2,918,518</b>
Management and general	640,009	-	-	640,009	567,917	-	-	567,917
Fundraising	427,267	-	-	427,267	403,816	-	-	403,816
<b>Total Expenses</b>	<b>3,829,870</b>	<b>-</b>	<b>-</b>	<b>3,829,870</b>	<b>3,890,251</b>	<b>-</b>	<b>-</b>	<b>3,890,251</b>
Change in Net Assets	(301,397)	462,154	-	160,757	1,735,718	203,474	-	1,939,192
<b>NET ASSETS</b>								
Beginning of year	4,813,481	861,292	250,000	5,724,773	2,877,763	657,818	250,000	3,785,581
End of year	\$ 4,312,084	\$ 1,323,446	\$ 250,000	\$ 5,885,530	\$ 4,813,481	\$ 861,292	\$ 250,000	\$ 5,724,773

See notes to financial statements

**Classroom, Inc.**

Statement of Functional Expenses

Year Ended June 30, 2012

EXPENSES	Educational Programs			Total Educational Programs	Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment				
Salaries and benefits	\$ 768,336	\$ 315,934	\$ 175,494	\$ 1,259,764	\$ 325,578	\$ 259,280	\$ 1,844,622
Professional fees	243,482	290,206	34,330	568,018	60,918	26,623	655,559
Donated legal services	-	-	-	-	64,747	-	64,747
Audit	14,096	5,126	2,563	21,785	3,844	-	25,629
Occupancy fees	302,796	158,950	73,935	535,681	128,113	105,322	769,116
Communications	13,081	6,909	3,113	23,103	5,543	5,027	33,673
Repairs and maintenance	8,701	5,621	2,579	16,901	16,465	2,885	36,251
Depreciation and amortization	11,219	4,080	2,040	17,339	3,059	-	20,398
Product supplies	43,032	-	1,680	44,712	-	-	44,712
Travel and conferences	138,020	6,691	198	144,909	2,780	5,899	153,588
Donated printing services	17,180	1,720	986	19,886	620	4,609	25,115
Other	68,331	31,032	11,133	110,496	28,342	17,622	156,460
<b>Total Expenses</b>	<b>\$ 1,628,274</b>	<b>\$ 826,269</b>	<b>\$ 308,051</b>	<b>\$ 2,762,594</b>	<b>\$ 640,009</b>	<b>\$ 427,267</b>	<b>\$ 3,829,870</b>

See notes to financial statements

**Classroom, Inc.**

Statement of Functional Expenses

Year Ended June 30, 2011

	Educational Programs				Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment	Total Educational Programs			
<b>EXPENSES</b>							
Salaries and benefits	\$ 868,762	\$ 287,143	\$ 170,667	\$ 1,326,572	\$ 283,842	\$ 236,834	\$ 1,847,248
Professional fees	297,295	130,309	23,937	451,541	75,831	53,569	580,941
Donated legal services	-	-	-	-	63,129	-	63,129
Audit	13,200	4,800	2,400	20,400	3,600	-	24,000
Occupancy fees	329,595	106,043	63,865	499,503	106,364	89,424	695,291
Communications	17,846	6,408	3,131	27,385	5,220	4,426	37,031
Repairs and maintenance	20,131	7,404	2,652	30,187	8,531	3,356	42,074
Depreciation and amortization	15,238	5,541	2,771	23,550	4,156	-	27,706
Product supplies	288,294	-	791	289,085	-	-	289,085
Travel and conferences	167,739	2,002	124	169,865	1,429	6,852	178,146
Donated printing services	25,156	-	2,417	27,573	1,528	1,262	30,363
Other	39,734	8,233	4,890	52,857	14,287	8,093	75,237
<b>Total Expenses</b>	<b>\$ 2,082,990</b>	<b>\$ 557,883</b>	<b>\$ 277,645</b>	<b>\$ 2,918,518</b>	<b>\$ 567,917</b>	<b>\$ 403,816</b>	<b>\$ 3,890,251</b>

See notes to financial statements

**Classroom, Inc.**

Statements of Cash Flows

Years Ended June 30,

	<u>2012</u>	<u>2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 160,757	\$ 1,939,192
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	20,398	27,706
Changes in operating assets and liabilities		
Pledges receivable	(49,820)	(72,165)
Fees and other receivables	692,094	(242,999)
Product inventories	(16,621)	100,780
Prepaid expenses and other assets	(3,547)	(4,321)
Accounts payable and accrued expenses	38,291	(93,024)
Deferred revenue	(117,782)	46,332
Net Cash from Operating Activities	<u>723,770</u>	<u>1,701,501</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(3,512)	(15,456)
Simulation development costs	(278,907)	-
Net Cash from Investing Activities	<u>(282,419)</u>	<u>(15,456)</u>
Change in Cash and Cash Equivalents	441,351	1,686,045
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of year	<u>3,854,250</u>	<u>2,168,205</u>
End of year	<u>\$ 4,295,601</u>	<u>\$ 3,854,250</u>

See notes to financial statements

## **Classroom, Inc.**

### Notes to Financial Statements June 30, 2012 and 2011

#### **1. Organization**

Since 1991 Classroom, Inc. ("CI"), an educational not-for-profit organization, has turned classrooms into learning environments that motivate students with innovative teaching methods, based on the idea that young people learn better when they are interested and engaged in their work. The programs are designed to help low-achieving adolescent students with the basic skills of reading and mathematics.

To accomplish this goal, CI (i) creates computer programs that place students in virtual workplaces where they use literacy, math and communications skills to make decisions and solve problems; (ii) creates printed materials that provide students with engaging and instructionally sound curricula that go along with each simulation; and (iii) offers educators a comprehensive professional development program. The curriculum is being used in middle and high school classrooms during the school day, in after-school programs, and during summer-school sessions in New York City and across the country.

CI is exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code and from state and local taxes under comparable laws.

#### **2. Summary of Significant Accounting Policies**

##### ***Basis of Presentation***

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

##### ***Use of Estimates***

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

##### ***Cash and cash equivalents***

For financial statement purposes, CI considers highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

##### ***Contributions, fees and other receivables***

Contributions are recorded as revenue at the time of receipt of the unconditional pledge of cash or other assets. Contributions are considered available for unrestricted use, unless the donors restrict the use thereof, either on a temporary or permanent basis. Contributions to be received after one year are discounted at an appropriate interest rate, commensurate with the risk involved.



**Classroom, Inc.**

Notes to Financial Statements  
June 30, 2012 and 2011

**2. Summary of Significant Accounting Policies (continued)**

***Contributions, fees and other receivables (continued)***

CI receives fees for services from school districts and other educational organizations which are recognized as revenue as services are performed, sometimes based on the proportion of direct costs incurred to total estimated direct costs. Fees received in advance are recorded as deferred revenue until the related services are performed.

Donated securities are recorded at fair value at the date of the gift and are generally sold immediately upon receipt by CI.

Interest and dividend income are recognized as unrestricted, temporarily restricted or permanently restricted in accordance with donors' intentions.

CI's management periodically evaluates receivable balances to determine whether an allowance for doubtful accounts should be established to cover amounts determined to be uncollectible. At June 30, 2012 and 2011, no such allowance was considered necessary.

***Product Inventories***

Product inventories consist primarily of printed learning materials and other educational supplies to be supplied to schools and other educational organizations and are valued at the lower of cost or market value, using the average cost method of valuation.

Costs incurred to ship product inventories to program participants are expensed as incurred. These costs are reported as "direct support to schools" expense in the accompanying statements of activities.

***Property and Equipment***

Property and equipment are stated at fair value at the date of donation. Leasehold improvements are capitalized, whereas the costs of repairs and maintenance are expensed as incurred.

Depreciation is provided using the straight-line method over the estimated useful lives of the assets, ranging from 3 to 7 years. Leasehold improvements are amortized over the remaining term of the respective lease or the useful life of the improvement, whichever is shorter.

***Simulation Development***

During fiscal year 2012, CI started a project to web-enable three simulations and to develop an additional three simulations. CI capitalizes only direct labor costs associated with the web-enabling and development of these simulations. Amortization of these costs will commence upon completion of each project using the straight-line method over the estimated useful lives of 3 to 7 years.

**Classroom, Inc.**

Notes to Financial Statements  
June 30, 2012 and 2011

**2. Summary of Significant Accounting Policies (continued)**

***Net Asset Presentation***

CI reports information regarding its financial position and activities according to three classes of net assets based on donor restrictions: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets represent those resources that are not subject to donor-imposed restrictions and are fully available, at the discretion of the Board of Directors and management, for CI to utilize in any of its programs or supporting services. The board-designated fund was established as an operating reserve to provide financial stability and to be used as a contingency fund for unanticipated events. Additionally, the Board designated a replenishment fund to provide for the replacement and acquisition of property and equipment in future periods. On an annual basis, the Board determines the amount to be maintained in each of these funds and approves the use of such funds to be used, if needed. (See Note 6 for a description of the Lacovara Opportunities Fund).

Temporarily restricted net assets represent those resources that have been restricted by donors for specific purpose or time frame. When a donor's time-restriction expires or a purpose-restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying statements of activities as "net assets released from restrictions."

Permanently restricted net assets represent those resources that have been restricted by donors to be held and invested in perpetuity.

***Functional allocation of expenses***

The costs of providing the various programs and supporting services have been summarized on a functional basis in the accompanying statements of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services in reasonable ratios determined by management.

***Accounting for Uncertainty in Income Taxes***

CI recognizes the effect of income tax positions only when they are more likely than not to be sustained. Management has determined that CI had no uncertain tax positions that would require financial statement recognition. CI is no longer subject to examinations by the applicable taxing jurisdictions for the periods prior to 2009.

***Subsequent Events Evaluation by Management***

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which is October 11, 2012.

**Classroom, Inc.**

Notes to Financial Statements  
June 30, 2012 and 2011

**3. Pledges receivable**

Pledges receivable are shown in the accompanying statements of financial position net of discounts to present value. Gross pledges of \$624,309 and \$551,796 at June 30, 2012 and 2011, with payments due in future years, were discounted to present value using a discount rate of approximately 2%. Pledge receivables are due as follows at June 30:

	<u>2012</u>	<u>2011</u>
Less than one year	\$ 304,377	\$ 521,796
Two to five years	<u>310,000</u>	<u>30,000</u>
	614,377	551,796
Discount to present value	<u>(12,946)</u>	<u>(185)</u>
	<u>\$ 601,431</u>	<u>\$ 551,611</u>

**4. Property and Equipment**

At June 30, 2012 and 2011 property and equipment, net of accumulated depreciation consisted of the following:

	<u>2012</u>	<u>2011</u>
Leasehold improvements	\$ 581,649	\$ 581,649
Equipment	242,347	247,713
Furniture and fixtures	<u>1,200</u>	<u>1,200</u>
	825,196	830,562
Accumulated depreciation	<u>(804,401)</u>	<u>(792,881)</u>
	<u>\$ 20,795</u>	<u>\$ 37,681</u>

There was \$8,878 of fully depreciated assets disposed of and written off during fiscal year 2012.

**5. Concentration of Credit Risk**

CI maintains its cash in bank deposit accounts with two major financial institutions, which, at times, may exceed federally insured limits. CI has not experienced any losses in such accounts and believes its cash balances are not exposed to any significant risk.

**6. Lacovara Opportunities Fund**

In fiscal-year 2003, CI established the Lacovara Opportunities Fund (the "Fund") to provide for new initiatives and to pilot projects that might otherwise be difficult to fund. The Fund consists of donor contributions to be used at the discretion of management, with the advice and consent of the Board of Directors. The Fund had a balance of \$686,929 at June 30, 2012 and 2011.

**Classroom, Inc.**

Notes to Financial Statements  
June 30, 2012 and 2011

**7. Temporarily Restricted Net Assets**

Temporarily restricted net assets are available for time and purposes at June 30 as follows:

	<u>2012</u>	<u>2011</u>
<b>Purpose restricted</b>		
Direct support to schools:		
New York	\$ 308,245	\$535,312
National Urban Districts	1,880	165,261
Research	61,048	93,783
Curriculum development:		
Publishing	480,000	30,215
Product Technology	-	5,000
	<u>831,173</u>	<u>829,571</u>
<b>Time restricted</b>	<u>492,273</u>	<u>31,721</u>
	<u>\$1,323,446</u>	<u>\$861,292</u>

At June 30, 2012 and 2011, respectively, approximately \$189,000 and \$552,000 of purpose-restricted amounts are also time-restricted.

Net assets were released from donor restrictions during the years ended June 30, which satisfied the restricted purposes specified by the donors or the passage of time as follows:

	<u>2012</u>	<u>2011</u>
<b>Purpose restricted</b>		
Direct support to schools:		
New York	\$ 403,815	\$469,678
National Urban Districts	30,891	-
Research	86,852	104,423
Curriculum development:		
Publishing	306,899	134,486
Product Technology	23,000	32,882
	<u>851,457</u>	<u>741,469</u>
<b>Time restricted</b>	<u>173,740</u>	<u>110,022</u>
	<u>\$1,025,197</u>	<u>\$851,491</u>

**8. Endowment Funds**

The endowment consists entirely of individual donor-restricted funds, in the amount of \$250,000, established for a variety of purposes. CI does not have any funds designated by the Board of Directors to function as an endowment.

**Classroom, Inc.**

Notes to Financial Statements  
June 30, 2012 and 2011

**8. Endowment Funds (continued)**

***Interpretation of Relevant Law***

The Board of Directors has interpreted the New York State Uniform Management of Institutional Funds Act ("NYPMIFA") as requiring the preservation of the historic dollar value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, CI classifies as permanently restricted nets assets:

- The original value of gifts and subsequent gifts donated to the permanent endowment, and
- Accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

***Changes in Endowment Net Assets***

There were no changes in the endowment net assets during fiscal year 2012. At June 30, 2012, the endowment net assets were held by CI in a money market account.

***Return objectives and risk parameters***

CI has adopted an investment approach for endowment assets that attempts to preserve the principal of the endowment assets. Under this approach, as approved by the Board of Directors, the endowment assets are invested in a prudent manner that is intended to preserve the principal, with a moderate rate of return, and a moderate level of investment risk.

***Strategies employed for achieving objectives***

During fiscal years 2012 and 2011, CI's endowment assets are cash-based investments in an effort to preserve the capital. CI continually assesses market conditions and, at the appropriate time, will exercise prudent management to meet its long-term investment objective of diversifying its assets and achieving investment returns through both capital appreciation (realized and unrealized) and current yield (interest and dividends).

***Spending Policy***

CI has no formal spending policy.

**9. Donated goods and services**

CI recorded revenues and corresponding expenses on product inventories for donated printing services and donated legal services during fiscal years 2012 and 2011, which are reported in the accompanying financial statements at their estimated fair values.

**Classroom, Inc.**

**Notes to Financial Statements  
June 30, 2012 and 2011**

**9. Donated goods and services (continued)**

In addition, a number of members of the Board of Directors have donated significant amounts of their time to CI's program services and supporting services. No amounts have been reported in the accompanying financial statements for these donated services, as they do not meet the criteria for revenue recognition under U.S. GAAP.

**10. Employee Benefit Plan**

CI maintains a defined-contribution 403(b) retirement plan (the "Plan") that provides benefits for substantially all of its employees. CI contributes an amount equal to 3% of each eligible participating employee's compensation to the Plan. If an employee also makes contributions to the Plan, CI will match the employee's contributions up to an additional 2% of compensation, as defined by the Plan. The maximum employer contribution is 5%. Contributions to the Plan for the years ended June 30, 2012 and 2011 were approximately \$66,000 and \$51,000, respectively.

**11. Commitments**

CI's non-cancelable operating lease for its office space will expire on December 31, 2018, with an option to renew for an additional five years.

Minimum future lease payments under the lease agreement are payable as follows:

2013	\$ 595,223
2014	621,780
2015	649,002
2016	665,227
2017	681,858
2018 - Thereafter	<u>1,052,670</u>
	<u>\$4,265,760</u>

Rent expense was approximately \$650,000 and \$591,000 for the years ended June 30, 2012 and 2011.

CI has also entered into operating lease agreements for its office equipment. Minimum future lease payments under these lease agreements are as follows:

2013	\$ 8,815
2014	8,815
2015	8,815
2016	<u>8,246</u>
	<u>\$ 34,691</u>

Lease expense under the equipment agreements was \$9,502 and \$14,263 for the years ended June 30, 2012 and 2011.

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