

Classroom, Inc.

Financial Statements

June 30, 2013 and 2012

Independent Auditors' Report

**Board of Directors of
Classroom Inc.**

We have audited the accompanying financial statements of Classroom Inc. ("CI"), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Classroom, Inc. as of June 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

O'Connor Davies, LLP

October 10, 2013

O'CONNOR DAVIES, LLP

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Classroom, Inc.

Statements of Financial Position
June 30,

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents	\$ 3,606,995	\$ 4,295,601
Pledges receivable, net	809,258	601,431
Fees and other receivables, net	313,492	226,754
Product inventories	410,075	385,998
Prepaid expenses and other assets	107,926	156,310
Endowment cash equivalent	250,000	250,000
Property and equipment, net	9,724	20,795
Simulation development	<u>882,931</u>	<u>278,907</u>
	<u>\$ 6,390,401</u>	<u>\$ 6,215,796</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 274,030	\$ 256,953
Deferred rent payable	71,808	43,163
Deferred revenue	<u>61,109</u>	<u>30,150</u>
	<u>406,947</u>	<u>330,266</u>
Net Assets		
Unrestricted	4,227,140	4,312,084
Temporarily restricted	1,506,314	1,323,446
Permanently restricted	<u>250,000</u>	<u>250,000</u>
Total Net Assets	<u>5,983,454</u>	<u>5,885,530</u>
	<u>\$ 6,390,401</u>	<u>\$ 6,215,796</u>

Classroom, Inc.

Statements of Activities
Years Ended June 30, 2013

	2013				2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE								
Contributions								
Individuals	\$ 1,530,111	\$ 69,914	\$ -	\$ 1,600,025	\$ 247,455	\$ 33,785	\$ -	\$ 281,240
Foundations and trusts	755,231	1,135,740	-	1,890,971	1,710,246	1,433,566	-	3,143,812
Corporations	16,536	20,451	-	36,987	29,279	20,000	-	49,279
Donated goods and services	67,682	-	-	67,682	89,862	-	-	89,862
Fees	384,741	-	-	384,741	409,401	-	-	409,401
Interest and dividends	8,772	-	-	8,772	9,820	-	-	9,820
Other revenue	17,219	-	-	17,219	7,213	-	-	7,213
Net assets released from restrictions	1,043,237	(1,043,237)	-	-	1,025,197	(1,025,197)	-	-
Total Support and Revenue	<u>3,823,529</u>	<u>182,868</u>	<u>-</u>	<u>4,006,397</u>	<u>3,528,473</u>	<u>462,154</u>	<u>-</u>	<u>3,990,627</u>
EXPENSES								
Educational Programs								
Direct support to schools	1,761,106	-	-	1,761,106	1,628,274	-	-	1,628,274
Curriculum development	545,568	-	-	545,568	826,269	-	-	826,269
Research and assessment	318,649	-	-	318,649	308,051	-	-	308,051
Total Educational Programs	<u>2,625,323</u>	<u>-</u>	<u>-</u>	<u>2,625,323</u>	<u>2,762,594</u>	<u>-</u>	<u>-</u>	<u>2,762,594</u>
Management and general	691,432	-	-	691,432	640,009	-	-	640,009
Fundraising	591,718	-	-	591,718	427,267	-	-	427,267
Total Expenses	<u>3,908,473</u>	<u>-</u>	<u>-</u>	<u>3,908,473</u>	<u>3,829,870</u>	<u>-</u>	<u>-</u>	<u>3,829,870</u>
Change in Net Assets	(84,944)	182,868	-	97,924	(301,397)	462,154	-	160,757
NET ASSETS								
Beginning of year	4,312,084	1,323,446	250,000	5,885,530	4,613,481	861,292	250,000	5,724,773
End of year	<u>\$ 4,227,140</u>	<u>\$ 1,506,314</u>	<u>\$ 250,000</u>	<u>\$ 5,983,454</u>	<u>\$ 4,312,084</u>	<u>\$ 1,323,446</u>	<u>\$ 250,000</u>	<u>\$ 5,885,530</u>

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2013

	Educational Programs			Total Educational Programs	Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment				
EXPENSES							
Salaries and benefits	\$ 863,583	\$ 258,697	\$ 165,702	\$ 1,287,982	\$ 414,105	\$ 329,631	\$ 2,031,718
Professional fees	191,257	45,830	61,289	298,376	47,448	93,955	439,779
Donated legal services	-	-	-	-	39,475	-	39,475
Audit	14,950	5,436	2,718	23,104	4,077	-	27,181
Occupancy fees	270,219	166,162	54,420	490,801	127,599	102,873	721,273
Office expenses	17,255	7,912	7,103	32,270	7,489	9,732	49,491
Communications	12,781	7,794	2,495	23,070	5,912	5,385	34,367
Repairs and maintenance	8,235	4,898	2,030	15,163	9,464	2,739	27,366
Depreciation and amortization	6,716	2,442	1,221	10,379	1,831	-	12,210
Product supplies	150,720	-	10,459	161,179	-	-	161,179
Travel and conferences	149,601	11,898	695	162,194	1,245	19,049	182,488
Donated printing services	13,449	-	761	14,210	4,896	9,101	28,207
Other	62,340	34,499	9,756	106,595	27,891	19,253	153,739
Total Expenses	\$ 1,761,106	\$ 545,568	\$ 318,649	\$ 2,625,323	\$ 691,432	\$ 591,718	\$ 3,908,473

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2012

	Educational Programs			Total Educational Programs	Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment				
EXPENSES							
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
Occupany 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
Total Expenses	\$ 1,628,274	\$ 826,269	\$ 308,051	\$ 2,762,594	\$ 640,009	\$ 427,267	\$ 3,829,870

Classroom, Inc.

Statements of Cash Flows
Years Ended June 30,

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 97,924	\$ 160,757
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	12,210	20,398
Donated investments	(499,493)	(9,932)
Changes in operating assets and liabilities		
Pledges receivable	(207,827)	(49,820)
Fees and other receivables	(86,738)	692,094
Product inventories	(24,077)	(16,621)
Prepaid expenses and other assets	48,384	(3,547)
Accounts payable and accrued expenses	17,077	38,291
Deferred rent payable and deferred revenue	59,604	(117,782)
Net Cash from Operating Activities	(582,936)	713,838
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(1,139)	(3,512)
Proceeds from sale of investments	499,493	9,932
Simulation development costs	(604,024)	(278,907)
Net Cash from Investing Activities	(105,670)	(272,487)
Change in Cash and Cash Equivalents	(688,606)	441,351
 CASH AND CASH EQUIVALENTS		
Beginning of year	4,295,601	3,854,250
End of year	\$ 3,606,995	\$ 4,295,601

Classroom, Inc.

Notes to Financial Statements June 30, 2013 and 2012

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 interdisciplinary programs are particularly designed to help low-achieving adolescent students with the basic skills.

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 based on a time or purpose restriction, 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, 2013 and 2012

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, 2013 and 2012, 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 cost at the time of purchase, or 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. 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, 2013 and 2012

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.

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 2010.

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 10, 2013.

Classroom, Inc.

Notes to Financial Statements June 30, 2013 and 2012

3. Pledges receivable

Pledges receivable are shown in the accompanying statements of financial position net of discounts to present value. Gross pledges of \$818,250 and \$614,377 at June 30, 2013 and 2012, with payments due in future years, were discounted to present value using a discount rate ranging from 2.2% to 3.5%. Pledge receivables are due as follows at June 30:

	2013	2012
Less than one year	\$ 556,250	\$ 304,377
Two to five years	262,000	310,000
	<u>818,250</u>	<u>614,377</u>
Discount to present value	(8,992)	(12,946)
	<u>\$ 809,258</u>	<u>\$ 601,431</u>

4. Property and Equipment

At June 30, 2013 and 2012 property and equipment, net of accumulated depreciation consisted of the following:

	2013	2012
Leasehold improvements	\$ 581,649	\$ 581,649
Equipment	233,526	242,347
Furniture and fixtures	1,200	1,200
	<u>816,375</u>	<u>825,196</u>
Accumulated depreciation	(806,651)	(804,401)
	<u>\$ 9,724</u>	<u>\$ 20,795</u>

There was \$9,960 of fully depreciated assets disposed of and written off during fiscal year 2013.

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.

Classroom, Inc.

Notes to Financial Statements
June 30, 2013 and 2012

6. Temporarily Restricted Net Assets

Temporarily restricted net assets with time and purpose restrictions at June 30 are as follows:

Purpose restricted	<u>2013</u>	<u>2012</u>
Direct support to schools:		
New York	\$ 326,826	\$ 308,245
National Urban Districts	23,000	1,880
Research	85,579	61,048
Curriculum development:		
Simulation Development	160,214	460,000
Capacity Building	<u>375,861</u>	<u>-</u>
	971,480	831,173
Time restricted	<u>534,834</u>	<u>492,273</u>
	<u>\$ 1,506,314</u>	<u>\$ 1,323,446</u>

At June 30, 2013 and 2012 approximately \$424,671 and \$189,000 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:

Purpose restricted	<u>2013</u>	<u>2012</u>
Direct support to schools:		
New York	\$ 376,678	\$ 403,815
National Urban Districts	12,381	30,891
Research	100,938	86,852
Curriculum development:		
Simulation Development	303,782	306,899
Product Technology	-	23,000
Capacity Building	<u>194,064</u>	<u>-</u>
	987,843	851,457
Time restricted	<u>55,394</u>	<u>173,740</u>
	<u>\$ 1,043,237</u>	<u>\$ 1,025,197</u>

7. 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.

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.

Classroom, Inc.

Notes to Financial Statements
June 30, 2013 and 2012

7. Endowment Funds *(continued)*

Interpretation of Relevant Law

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 2013. At June 30, 2013, the endowment net assets were held by CI in a savings 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 2013 and 2012, 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 received donations that are restricted by donors to be held and invested in perpetuity. The principal is restricted. The net capital appreciation/depreciation, interest and dividends are unrestricted. CI's permanent restricted net assets are invested in a savings account. The interest and dividends are transferred to CI's checking account to support general operations.

8. Donated goods and services

CI recorded revenues and corresponding expenses on product inventories for donated printing services and donated legal services during fiscal years 2013 and 2012, which are reported in the accompanying financial statements at their estimated fair values.

Classroom, Inc.

Notes to Financial Statements June 30, 2013 and 2012

8. 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 recognition under U.S. GAAP.

9. 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, 2013 and 2012 were approximately \$64,000 and \$66,000.

10. 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:

2014	\$ 621,780
2015	649,002
2016	665,227
2017	681,858
2018	698,904
2019 - Thereafter	<u>353,766</u>
	<u>\$ 3,670,537</u>

Rent expense was approximately \$648,000 and \$650,000 for the years ended June 30, 2013 and 2012.

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

2014	\$ 8,815
2015	8,815
2016	<u>8,246</u>
	<u>\$ 25,876</u>

Lease expense under the equipment agreements was \$10,564 and \$9,502 for the years ended June 30, 2013 and 2012.