

Eisner

Eisner LLP
Accountants and Advisors

CLASSROOM, INC.

FINANCIAL STATEMENTS

JUNE 30, 2008 and 2007

Eisner

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Accountants and Advisors

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Classroom, Inc.
New York, New York

We have audited the accompanying statements of financial position of Classroom, Inc. ("CI") as of June 30, 2008 and 2007, and the related statements of activities and cash flows for the years 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 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Classroom, Inc. as of June 30, 2008 and 2007, and the changes 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.

Eisner LLP

New York, New York
October 17, 2008

CLASSROOM, INC.**Statements of Financial Position**

	June 30,	
	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and cash equivalents	\$ 1,264,195	\$ 932,099
Investments	2,423,705	2,542,354
Pledges receivable, net	952,126	1,150,058
Fees and other receivables, net	924,446	1,258,697
Product inventories	508,278	325,262
Prepaid expenses and other assets	129,549	139,245
Property and equipment, net	<u>141,448</u>	<u>233,466</u>
	<u>\$ 6,343,747</u>	<u>\$ 6,581,181</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 440,173	\$ 290,317
Deferred revenue	<u>168,175</u>	<u>252,812</u>
Total liabilities	<u>608,348</u>	<u>543,129</u>
Commitments and contingencies (Note K)		
Net assets:		
Unrestricted:		
General	2,593,425	2,847,150
Lacovara Opportunities Fund	686,929	686,929
Board-designated for contingencies	500,000	500,000
Replenishment fund	<u>350,000</u>	<u>350,000</u>
Total unrestricted	4,130,354	4,384,079
Temporarily restricted	1,344,092	1,378,881
Permanently restricted	<u>260,953</u>	<u>275,092</u>
Total net assets	<u>5,735,399</u>	<u>6,038,052</u>
	<u>\$ 6,343,747</u>	<u>\$ 6,581,181</u>

CLASSROOM, INC.

Statements of Activities

	Year Ended June 30,			
	2008		2007	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:				
Contributions:				
Individuals	\$ 549,069	\$ 1,199,870	\$ 520,589	\$ 520,589
Foundations and trusts	974,064	30,000	785,162	1,993,943
Corporations	79,200		102,470	141,712
Donated goods and services	152,372		121,535	121,535
Fees	1,174,432		1,647,158	1,647,158
Interest and dividends	171,037		169,758	169,758
Net realized and unrealized (losses) gains on investments	(349,920)	\$ (14,139)	(2,868)	22,224
Other revenue	36,766		51,440	51,440
	<u>2,787,020</u>	<u>1,229,870</u>	<u>3,395,244</u>	<u>4,668,359</u>
Total support and revenue before release from restrictions		(14,139)		25,092
Net assets released from restrictions	<u>1,264,659</u>	<u>(1,264,659)</u>	<u>1,201,122</u>	<u>0</u>
Total support and revenue	<u>4,051,679</u>	<u>(34,789)</u>	<u>4,596,366</u>	<u>4,668,359</u>
Expenses:				
Program services:				
Program initiatives	2,300,253		2,067,513	2,067,513
Curriculum development	876,078		837,557	837,557
Research and assessment	224,745		236,587	236,587
Total program services	<u>3,401,076</u>		<u>3,141,657</u>	<u>3,141,657</u>
Management and general	500,171		471,766	471,766
Fund-raising activities	404,157		466,478	466,478
Total expenses	<u>4,305,404</u>		<u>4,079,901</u>	<u>4,079,901</u>
Change in net assets	<u>(253,725)</u>	<u>(34,789)</u>	<u>516,465</u>	<u>588,458</u>
Net assets - beginning of year	<u>4,384,079</u>	<u>1,378,881</u>	<u>3,867,614</u>	<u>5,449,594</u>
Net assets - end of year	<u>\$ 4,130,354</u>	<u>\$ 1,344,092</u>	<u>\$ 4,384,079</u>	<u>\$ 6,038,052</u>

CLASSROOM, INC.**Statements of Cash Flows**

	Year Ended June 30,	
	2008	2007
Cash flows from operating activities:		
Change in net assets	\$ (302,653)	\$ 588,458
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	109,198	93,825
Net realized and unrealized losses (gains) on investments	364,059	(22,224)
Donated securities	(465,220)	(261,287)
Changes in:		
Pledges receivable	197,932	(168,324)
Fees and other receivable	334,251	(634,205)
Product inventories	(183,016)	37,152
Prepaid expenses and other assets	9,696	(53,591)
Accounts payable and accrued expenses	149,856	40,231
Deferred revenue	(84,637)	37,805
Net cash provided by (used in) operating activities	<u>129,466</u>	<u>(342,160)</u>
Cash flows from investing activities:		
Purchases of investments	(1,055,410)	(1,827,068)
Proceeds from sales of investments	1,275,220	2,103,923
Purchases of property and equipment	(17,180)	(120,259)
Net cash provided by investing activities	<u>202,630</u>	<u>156,596</u>
Net change in cash	332,096	(185,564)
Cash and cash equivalents - beginning of year	<u>932,099</u>	<u>1,117,663</u>
Cash and cash equivalents - end of year	\$ <u>1,264,195</u>	\$ <u>932,099</u>

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE A - ORGANIZATION AND ITS SIGNIFICANT ACCOUNTING POLICIES

[1] The 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] Basis of accounting:

The accompanying financial statements have been prepared using the accrual basis of accounting and conform to accounting principles generally accepted in the United States of America, as applicable to not-for-profit organizations.

[3] Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

[4] Cash and cash equivalents:

For financial-reporting purposes, CI considers highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

[5] Investments:

Investments in fixed-income mutual funds and an equity-index fund are stated at their fair values, based on quoted market prices, with realized and unrealized gains and losses included in the accompanying statements of activities. Donated securities are recorded at their fair values on the dates of the gifts and are generally sold immediately upon receipt by CI. Interest and dividend income, as well as realized and unrealized appreciation or depreciation in investment value, are recognized as unrestricted, temporarily restricted or permanently restricted, in accordance with donors' intentions.

[6] Contributions, fees and other receivables:

Contributions to CI are recorded as revenue at the receipt of unconditional pledges or 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.

CI receives fees for services to school districts and other educational organizations; fees 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.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE A - ORGANIZATION AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[6] Contributions, fees and other receivables: (continued)

CI 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, 2008 and 2007, no such allowance was considered necessary.

[7] Inventories:

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 reported as "program initiatives" expense in the accompanying statements of activities.

[8] Property and equipment:

Property and equipment are stated at their costs at the dates of acquisition or at their fair values at the dates 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.

[9] Accrued vacation:

Based on their tenure, CI's employees are entitled to be paid for unused vacation time if they leave the organization. Accordingly, at each fiscal year-end, the financial statements report a liability for the obligation that would be incurred if all employees with such unused vacation were to leave.

[10] Net assets:

CI's net assets and changes therein are classified and reported as follows:

(i) Unrestricted:

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 by the Board 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 E for a description of the Lacovara Opportunities Fund.)

(ii) Temporarily restricted:

Temporarily restricted net assets represent those resources that have been restricted by donors for specific purposes. 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."

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE A - ORGANIZATION AND ITS SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[10] Net assets: (continued)

(iii) Permanently restricted:

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

[11] 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 activities. Accordingly, certain costs have been allocated among the programs and supporting services in reasonable ratios determined by management.

[12] New accounting pronouncements:

In July 2006, the Financial Accounting Standards Board (the "FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 establishes for all financial enterprises, including not-for-profit organizations to the extent applicable, a requirement for financial-statement recognition of any benefits that the enterprise may expect to receive as the result of a position taken with regard to income taxes, as well as expanded tax-related disclosures. CI will be required to adopt FIN 48 for fiscal-year 2010, but, due to CI's general tax-exempt status, such adoption is not expected to have a material effect on its financial statements.

In September 2006, the FASB also released Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurement," which defines fair value, establishes a framework for the measurement of the fair value of an enterprise's assets and liabilities in various circumstances, and enhances disclosures about fair-value measurements. CI will be required to adopt SFAS No. 157 for fiscal-year 2009, but the adoption of the new standard is not expected to have a material effect on its financial statements.

In August 2008, the FASB released a Staff Position document (FSP), FAS 117-1, "Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds." The FSP requires expanded disclosures about the activities in an organization's endowment funds (both donor-restricted and board-designated) and will be effective for CI in fiscal year 2009.

NOTE B - INVESTMENTS

At each fiscal year-end, the cost and fair value of investments were as follows:

	June 30,			
	2008		2007	
	Fair Value	Cost	Fair Value	Cost
Mutual funds:				
Fixed-income	\$ 2,292,869	\$ 2,602,516	\$ 2,391,894	\$ 2,406,709
Equity-index	<u>130,836</u>	<u>125,000</u>	<u>150,460</u>	<u>125,000</u>
	<u>\$ 2,423,705</u>	<u>\$ 2,727,516</u>	<u>\$ 2,542,354</u>	<u>\$ 2,531,709</u>

CLASSROOM, INC.

**Notes to Financial Statements
June 30, 2008 and 2007**

NOTE B – INVESTMENTS (CONTINUED)

During each fiscal year, investment income consisted of the following:

	<u>Year Ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Interest and dividends, net	\$ 171,037	\$ 169,758
Net realized losses on sale of investments	(49,603)	(8,697)
Net unrealized (losses) gains on investments	<u>(314,456)</u>	<u>30,921</u>
	<u>\$ (193,022)</u>	<u>\$ 191,982</u>

Interest and dividends were reported net of investment fees of \$10,614 and \$12,452 for fiscal-years 2008 and 2007, respectively.

NOTE C - PLEDGES RECEIVABLE AND FEES AND OTHER RECEIVABLE

[1] At each fiscal year-end, pledges receivable were estimated to be due as follows:

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Less than one year	\$ 766,000	\$ 839,273
Two to five years	<u>200,000</u>	<u>340,000</u>
	966,000	1,179,273
Reduction of pledges due in excess of one year to present value, using rates ranging from 4% to 5%	<u>13,874</u>	<u>29,215</u>
	<u>\$ 952,126</u>	<u>\$ 1,150,058</u>

[2] As of June 30, 2008 and 2007, CI's fees and other receivables due from New York City school districts represented approximately 36% and 47%, respectively, of its total fees and other receivables.

NOTE D - PROPERTY AND EQUIPMENT

At each fiscal year-end, property and equipment consisted of the following:

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Leasehold improvements	\$ 584,815	\$ 584,815
Equipment	638,335	621,155
Donated furniture and fixtures	46,900	46,900
Donated equipment	<u>36,996</u>	<u>36,996</u>
	1,307,046	1,289,866
Less accumulated depreciation and amortization	<u>1,165,598</u>	<u>1,056,400</u>
	<u>\$ 141,448</u>	<u>\$ 233,466</u>

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE E - 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 approximately \$687,000 at both June 30, 2008 and June 30, 2007.

NOTE F - TEMPORARILY RESTRICTED NET ASSETS

[1] At each fiscal year-end, temporarily restricted net assets consisted of the following:

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Purpose-restricted:		
Program initiatives:		
New York	\$ 574,765	\$ 476,927
National Urban Districts	13,201	117,013
Research	39,000	47,000
Curriculum development:		
Publishing	70,000	237,600
Law and Justice		26,706
Performing Arts		952
	<u>696,966</u>	<u>906,198</u>
Time-restricted	<u>647,126</u>	<u>472,683</u>
	<u>\$ 1,344,092</u>	<u>\$ 1,378,881</u>

At June 30, 2008 and 2007, respectively, approximately \$661,000 and \$500,000 of purpose-restricted amounts are also time-restricted.

[2] During each fiscal year, temporarily restricted net assets were released in fulfillment of the following restrictions:

	<u>Year Ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Purpose-restricted:		
Program restrictions satisfied:		
New York	\$ 636,333	\$ 391,812
National Urban Districts	105,812	170,820
Research and assessment	14,352	38,721
Curriculum development satisfied:		
Publishing	252,649	429,515
Law and Justice	26,706	10,254
Performing Arts	952	
Product Technology	27,855	
	<u>1,064,659</u>	<u>1,041,122</u>
Time restrictions satisfied	<u>200,000</u>	<u>160,000</u>
	<u>\$ 1,264,659</u>	<u>\$ 1,201,122</u>

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE G - DONATED GOODS AND SERVICES

CI recorded revenues and corresponding expenses or product inventories for donated printing services and pro bono legal services during fiscal-years 2008 and 2007, which are reflected in the accompanying financial statements at their estimated fair values.

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 generally accepted accounting principles.

NOTE H - 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 fiscal-years 2008 and 2007 were approximately \$66,000 and \$71,000, respectively.

NOTE I - CONCENTRATION OF CREDIT RISK

CI maintains its cash and cash equivalents in bank accounts the balances of which, from time to time, may exceed federally insured limits. CI has not experienced any losses in such accounts. Management believes that CI is not exposed to any significant risk of loss on these bank accounts. Likewise, CI's investments are held at major financial institutions, and management believes that there is no significant risk that such institutions will fail.

NOTE J - RELATED-PARTY TRANSACTIONS

One member of the Board of Directors is an advisory director of the financial firm which acts as the investment custodian for CI, and provides investment advisory services to CI. In addition, another member of the Board is a principal with a strategic marketing and communications firm which has agreed with CI to provide at cost (\$3,750) a public relations campaign to publicize CI's summer school programs.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2008 and 2007

NOTE K - COMMITMENTS AND CONTINGENCIES

With regard to its office space, subsequent to June 30, 2008, CI agreed to new terms for its non-cancelable operating lease. The lease will now expire on December 31, 2018, although CI has an option to extend the lease term for an additional five years. The lease contains a provision for scheduled increases in the minimum rent and provides for adjustments to base rentals based upon increases in the Consumer Price Index. Minimum future lease payments under the lease agreement are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2009	\$ 431,377
2010	552,723
2011	566,542
2012	580,705
2013	595,223
2014	621,780
2015	649,002
2016	665,227
2017	681,858
2018	698,904
2019	<u>353,766</u>
	<u>\$ 6,397,107</u>

Rent expense was approximately \$424,000 and \$425,000 for fiscal-years 2008 and 2007, respectively.

In addition, CI leases certain office equipment, pursuant to noncancellable operating leases. Future minimum lease commitments as of June 30, 2008 were as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2009	\$ 12,000
2010	11,000
2011	6,000
2012	<u>1,000</u>
	<u>\$ 30,000</u>

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