

Classroom, Inc.

Financial Statements

June 30, 2011



Independent Auditors' Report

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

We have audited the accompanying statement of financial position of the Classroom, Inc. ("CI") as of June 30, 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. The financial statements of CI as of June 30, 2010 were audited by other auditors whose report dated October 7, 2010 expressed an unqualified opinion on those financial statements.

We conducted our audit 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 the 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 audit provides 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, 2011 and the change in its net assets, and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

O'Connor Davies Munns & Dobbins, LLP

New York, New York
October 6, 2011

Classroom, Inc.

Statements of Financial Position

June 30,

	<u>2011</u>	<u>2010</u>
ASSETS		
Cash and cash equivalents	\$ 3,854,250	\$ 2,168,205
Pledges receivable, net	551,611	479,446
Fees and other receivables, net	918,848	675,849
Product inventories	369,377	470,157
Prepaid expenses and other assets	152,763	148,442
Restricted cash equivalent	250,000	250,000
Property and equipment, net	<u>37,681</u>	<u>49,932</u>
	<u>\$ 6,134,530</u>	<u>\$ 4,242,031</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 218,662	\$ 311,687
Deferred revenue	<u>191,095</u>	<u>144,763</u>
	<u>409,757</u>	<u>456,450</u>
Net Assets		
Unrestricted		
General	3,076,552	1,340,834
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	4,613,481	2,877,763
Temporarily restricted	861,292	657,818
Permanently restricted	<u>250,000</u>	<u>250,000</u>
Total Net Assets	<u>5,724,773</u>	<u>3,785,581</u>
	<u>\$ 6,134,530</u>	<u>\$ 4,242,031</u>

See notes to financial statements

Classroom, Inc.

Statements of Activities

Years Ended June 30,

	2011			2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE							
Contributions							
Individuals	\$ 353,501	\$ 9,800	\$ -	\$ 467,785	\$ -	\$ -	\$ 467,785
Foundations and trusts	3,204,595	1,000,165	-	765,225	705,706	-	1,470,931
Corporations	76,488	45,000	-	21,198	50,000	-	71,198
Donated goods and services	93,492	-	-	79,052	-	-	79,052
Fees	1,021,334	-	-	1,011,389	-	-	1,011,389
Interest and dividends	7,226	-	-	3,244	-	-	3,244
Other revenue	17,842	-	-	5,802	-	-	5,802
Net assets released from restrictions	851,491	(851,491)	-	1,104,628	(1,104,628)	-	-
Total Support and Revenue	<u>5,625,969</u>	<u>203,474</u>	<u>-</u>	<u>3,458,323</u>	<u>(348,922)</u>	<u>-</u>	<u>3,109,401</u>
EXPENSES							
Educational Programs							
Direct support to schools	2,082,990	-	-	2,471,301	-	-	2,471,301
Curriculum development	557,883	-	-	591,101	-	-	591,101
Research and assessment	277,645	-	-	208,840	-	-	208,840
Total Educational Programs	<u>2,918,518</u>	<u>-</u>	<u>-</u>	<u>3,271,242</u>	<u>-</u>	<u>-</u>	<u>3,271,242</u>
Management and general							
Fundraising	567,917	-	-	489,276	-	-	489,276
Total Expenses	<u>403,816</u>	<u>-</u>	<u>-</u>	<u>424,871</u>	<u>-</u>	<u>-</u>	<u>424,871</u>
Total Expenses	<u>3,890,251</u>	<u>-</u>	<u>-</u>	<u>4,185,389</u>	<u>-</u>	<u>-</u>	<u>4,185,389</u>
Change in Net Assets	1,735,718	203,474	-	(727,066)	(348,922)	-	(1,075,988)
NET ASSETS							
Beginning of year	<u>2,877,763</u>	<u>657,818</u>	<u>250,000</u>	<u>3,604,829</u>	<u>1,006,740</u>	<u>250,000</u>	<u>4,861,569</u>
End of year	<u>\$ 4,613,481</u>	<u>\$ 861,292</u>	<u>\$ 250,000</u>	<u>\$ 2,877,763</u>	<u>\$ 657,818</u>	<u>\$ 250,000</u>	<u>\$ 3,785,581</u>

See notes to financial statements

Classroom, Inc.

Statement of Functional Expenses

Year Ended June 30, 2011

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

Classroom, Inc.

Statement of Functional Expenses

Year Ended June 30, 2010

	Educational Programs					Total	Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment	Total Educational Programs	Management and General				
EXPENSES									
Salaries and benefits	\$ 1,177,009	\$ 347,821	\$ 127,467	\$ 1,652,297	\$ 275,943	\$ 284,578	\$ 2,212,818		
Professional fees	316,916	109,466	18,075	444,457	34,826	28,186	507,469		
Donated legal services	-	-	-	-	52,914	-	52,914		
Audit	20,900	7,600	3,800	32,300	5,700	-	38,000		
Occupancy fees	361,557	103,330	38,432	503,319	82,949	85,674	671,942		
Communications	16,611	4,845	1,747	23,203	3,815	3,672	30,690		
Repairs and maintenance	14,615	3,359	1,580	19,554	9,196	2,566	31,316		
Depreciation and amortization	24,322	8,844	4,422	37,588	6,634	-	44,222		
Product supplies	309,273	275	8,770	318,318	-	-	318,318		
Travel and conferences	169,897	500	969	171,366	899	3,030	175,295		
Donated printing services	16,307	-	249	16,556	2,113	7,469	26,138		
Other	43,894	5,061	3,329	52,284	14,287	9,696	76,267		
Total Expenses	\$ 2,471,301	\$ 591,101	\$ 208,840	\$ 3,271,242	\$ 489,276	\$ 424,871	\$ 4,185,389		

Classroom, Inc.
 Statements of Cash Flows
 Years Ended June 30,

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,939,192	\$ (1,075,988)
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	27,706	44,222
Changes in operating assets and liabilities		
Pledges receivable	(72,165)	155,544
Fees and other receivables	(242,999)	159,402
Product inventories	100,780	(80,452)
Prepaid expenses and other assets	(4,321)	(9,059)
Accounts payable and accrued expenses	(93,024)	32
Deferred revenue	46,332	(29,209)
Net Cash from Operating Activities	<u>1,701,501</u>	<u>(835,508)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	<u>(15,456)</u>	<u>(35,283)</u>
Net Cash from Investing Activities	<u>(15,456)</u>	<u>(35,283)</u>
 Change in Cash and Cash Equivalents	1,686,045	(870,791)
 CASH AND CASH EQUIVALENTS		
Beginning of year	<u>2,168,205</u>	<u>3,038,996</u>
End of year	<u>\$ 3,854,250</u>	<u>\$ 2,168,205</u>

Classroom, Inc.

Notes to Financial Statements

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect certain reported amounts of assets, liabilities and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Basis of 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).

Classroom, Inc.

Notes to Financial Statements

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

Basis of Presentation (continued)

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.

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 to CI 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.

CI receives fees for services from 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.

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 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, 2011 and 2010, no such allowance was considered necessary.

Classroom, Inc.

Notes to Financial Statements

2. Summary of Significant Accounting Policies (continued)

Inventory

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 "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.

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.

Endowment

On September 17, 2010, New York State adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA includes provisions that differ from previous law, including the elimination of the historic dollar value rule with respect to endowment spending, establishment of new standards governing the expenditure and modification of restrictions on endowment funds, and revision of the prudence standard for the management and investment of endowment funds.

In accordance with the adoption of UPMIFA, CI reviewed all of its endowment funds and determined that a net asset reclassification was not necessary.

Reclassifications

Certain amounts for 2010 have been reclassified to conform with the presentation of the 2011 amounts. The reclassifications have no effect on net income for 2010.

Classroom, Inc.

Notes to Financial Statements

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

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 2008.

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 6, 2011.

3. Pledges receivable

Pledges receivable are shown in the accompanying statements of financial position net of discounts to present value. Gross pledges of \$551,796 and \$479,751 at June 30, 2011 and 2010, with payments due in future years, were discounted to present value using discount rates ranging from 1% to 5%. Pledge receivables are due as follows at June 30:

	2011	2010
Less than one year	\$ 521,796	\$ 438,751
Two to five years	30,000	41,000
	551,796	479,751
Discount to present value	(185)	(305)
	<u>\$ 551,611</u>	<u>\$ 479,446</u>

4. Property and Equipment

At June 30, 2011 and 2010 property and equipment, net of accumulated depreciation consisted of the following:

	2011	2010
Leasehold improvements	\$ 581,649	\$ 580,006
Equipment	247,713	262,252
Furniture and fixtures	1,200	1,200
	830,562	843,458
Accumulated depreciation	(792,881)	(793,526)
	<u>\$ 37,681</u>	<u>\$ 49,932</u>

Classroom, Inc.

Notes to Financial Statements

4. Property and Equipment *(continued)*

There was \$28,351 of fully depreciated assets disposed of and written off during fiscal year 2011.

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 approximately \$687,000 at June 30, 2011 and 2010.

7. Temporarily Restricted Net Assets

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

	2011	2010
Purpose restricted		
Direct support to schools:		
New York	\$ 535,312	\$ 295,960
National Urban Districts	165,261	-
Research	93,783	57,214
Curriculum development:		
Publishing	30,215	137,579
Product Technology	5,000	64,367
	829,571	555,120
Time restricted	31,721	102,698
	<u>\$ 861,292</u>	<u>\$ 657,818</u>

At June 30, 2011 and 2010, respectively, approximately \$552,000 and \$479,000 of purpose-restricted amounts are also time-restricted.

Classroom, Inc.

Notes to Financial Statements

7. Temporarily Restricted Net Assets *(continued)*

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>2011</u>	<u>2010</u>
Purpose restricted		
Direct support to schools:		
New York	\$ 469,678	\$ 549,110
National Urban Districts Research	-	75,000
	104,423	111,418
Curriculum development:		
Publishing	134,486	163,003
Product Technology	<u>32,882</u>	<u>59,544</u>
	741,469	958,075
Time restricted	<u>110,022</u>	<u>146,553</u>
	<u>\$ 851,491</u>	<u>\$ 1,104,628</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.

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.

Classroom, Inc.

Notes to Financial Statements

8. Endowment Funds *(continued)*

Changes in Endowment Net Assets, for fiscal-year June 30, 2011

There were no changes in the endowment net assets during fiscal year 2011. At June 30, 2011, 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

Due to continuing volatile market conditions, CI has moved its endowment assets to cash-based investments during fiscal-year 2009 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 or product inventories for donated printing services and donated legal services during fiscal years 2011 and 2010, which are reported 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.

Classroom, Inc.

Notes to Financial Statements

10. Employee Benefit Plan

CI maintains a defined-contribution 403(b) retirement plan (the "Plan") that provides benefits for substantially all of its employees. CRI 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, 2011 and 2010 were approximately \$51,000 and \$64,000, respectively.

11. Commitments

In September 2008, CI's non-cancelable operating lease for its office space was amended. The lease will expire on December 31, 2018, with an option to renew for an additional five years. The new lease payments were effective beginning January 1, 2009. CI's prior lease agreement provided for adjustments to base rentals, based upon increases in the Consumer Price Index.

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

2012	\$ 580,705
2013	595,223
2014	621,780
2015	649,002
2016	665,227
2017 - Thereafter	<u>1,734,528</u>
	<u>\$ 4,846,465</u>

Rent expense was approximately \$591,000 and \$566,000 for the years ended June 30, 2011 and 2010, respectively.

Commencing on September 1, 2010 and continuing on a month to month basis, CI subleases a workstation/cubicle at their offices for a monthly fee of \$500.