



CLASSROOM, INC.

FINANCIAL STATEMENTS

JUNE 30, 2010 and 2009

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, 2010 and 2009, and the related statements of activities, functional expenses 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 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 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 Classroom, Inc. as of June 30, 2010 and 2009, and the changes in its net assets, functional expenses, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



New York, New York
October 7, 2010

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

	June 30,	
	2010	2009
ASSETS		
Cash and cash equivalents	\$ 2,208,702	\$ 3,079,493
Restricted cash equivalent	209,503	209,503
Pledges receivable, net	479,446	634,990
Fees and other receivables, net	675,849	835,251
Product inventories	470,157	389,705
Prepaid expenses and other assets	148,442	139,383
Property and equipment, net	49,932	58,871
	<u>\$ 4,242,031</u>	<u>\$ 5,347,196</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 311,687	\$ 311,655
Deferred revenue	144,763	173,972
Total liabilities	<u>456,450</u>	<u>485,627</u>
Commitments (Note J)		
Net assets:		
Unrestricted:		
General	1,340,834	2,067,900
Lacovara Opportunities Fund	686,929	686,929
Board-designated for contingencies	500,000	500,000
Replenishment fund	350,000	350,000
Total unrestricted	2,877,763	3,604,829
Temporarily restricted	657,818	1,006,740
Permanently restricted	250,000	250,000
Total net assets	<u>3,785,581</u>	<u>4,861,569</u>
	<u>\$ 4,242,031</u>	<u>\$ 5,347,196</u>

CLASSROOM, INC.

Statements of Activities

	Year Ended June 30,							
	2010			2009				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:								
Contributions:								
Individuals	\$ 467,784			\$ 467,784	\$ 512,587	\$ 150,000		\$ 662,587
Foundations and trusts	765,225	\$ 705,706		1,470,931	995,072	778,614		1,773,686
Corporations	21,198	50,000		71,198	72,405	10,000		82,405
Donated goods and services	79,052			79,052	139,262			139,262
Fees	1,011,391			1,011,391	1,021,604			1,021,604
Interest and dividends	3,244			3,244	75,365			75,365
Net realized and unrealized losses on investments					(266,389)			(266,389)
Other revenue	5,801			5,801	13,657			13,657
	<u>2,353,695</u>	<u>755,706</u>		<u>3,109,401</u>	<u>2,563,563</u>	<u>938,614</u>		<u>3,502,177</u>
Total support and revenue before release from restrictions								
Net assets released from restrictions	<u>1,104,628</u>	<u>(1,104,628)</u>		<u>0</u>	<u>1,275,966</u>	<u>(1,275,966)</u>		<u>0</u>
Total support and revenue	<u>3,458,323</u>	<u>(348,922)</u>		<u>3,109,401</u>	<u>3,839,529</u>	<u>(337,352)</u>		<u>3,502,177</u>
Expenses:								
Educational programs:								
Direct support to schools	2,471,301			2,471,301	2,274,310			2,274,310
Curriculum development	591,101			591,101	877,561			877,561
Research and assessment	208,840			208,840	229,568			229,568
	<u>3,271,242</u>			<u>3,271,242</u>	<u>3,381,439</u>			<u>3,381,439</u>
Total educational programs								
Management and general	489,276			489,276	570,012			570,012
Fund-raising activities	424,871			424,871	424,556			424,556
	<u>4,185,389</u>			<u>4,185,389</u>	<u>4,376,007</u>			<u>4,376,007</u>
Total expenses								
Decrease in net assets	(727,066)	(348,922)		(1,075,988)	(536,478)	(337,352)		(873,830)
Net assets - beginning of year	<u>3,604,829</u>	<u>1,006,740</u>	<u>\$ 250,000</u>	<u>4,861,569</u>	<u>4,141,307</u>	<u>1,344,092</u>	<u>\$ 250,000</u>	<u>5,735,399</u>
Net assets - end of year	<u>\$ 2,877,763</u>	<u>\$ 657,818</u>	<u>\$ 250,000</u>	<u>\$ 3,785,581</u>	<u>\$ 3,604,829</u>	<u>\$ 1,006,740</u>	<u>\$ 250,000</u>	<u>\$ 4,861,569</u>

See notes to financial statements

CLASSROOM, INC.

**Statement of Functional Expenses
Year Ended June 30, 2010**

	Educational Programs			Management and General	Fund- Raising	Total	
	Direct Support to Schools	Curriculum Development	Research and Assessment				Total Educational Programs
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	<u>43,894</u>	<u>5,061</u>	<u>3,329</u>	<u>52,284</u>	<u>14,287</u>	<u>9,696</u>	<u>76,267</u>
Total expenses	<u>\$ 2,471,301</u>	<u>\$ 591,101</u>	<u>\$ 208,840</u>	<u>\$ 3,271,242</u>	<u>\$ 489,276</u>	<u>\$ 424,871</u>	<u>\$ 4,185,389</u>

CLASSROOM, INC.

**Statement of Functional Expenses
Year Ended June 30, 2009**

	Educational Programs			Management and General	Fund- Raising	Total	
	Direct Support to Schools	Curriculum Development	Research and Assessment				Total Educational Programs
Expenses:							
Salaries and benefits	\$ 1,047,455	\$ 517,806	\$ 145,303	\$ 1,710,564	\$ 324,307	\$ 299,175	\$ 2,334,046
Professional fees	270,346	172,443	18,182	460,971	35,048	8,606	504,625
Donated legal services					70,858		70,858
Audit	20,900	7,600	3,800	32,300	5,700		38,000
Occupancy fees	297,660	139,642	40,258	477,560	85,923	83,209	646,692
Communications	18,422	5,771	1,751	25,944	3,952	3,317	33,213
Repairs and maintenance	9,042	4,196	1,144	14,382	4,953	2,218	21,553
Depreciation and amortization	60,726	22,082	11,041	93,849	16,562		110,411
Product supplies	333,354		3,569	336,923	22		336,945
Travel and conferences	115,293	1,152	7	116,452	2,759	1,711	120,922
Donated printing services	39,610	1,190		40,800	8,501	16,618	65,919
Other	<u>61,502</u>	<u>5,679</u>	<u>4,513</u>	<u>71,694</u>	<u>11,427</u>	<u>9,702</u>	<u>92,823</u>
Total expenses	<u>\$ 2,274,310</u>	<u>\$ 877,561</u>	<u>\$ 229,568</u>	<u>\$ 3,381,439</u>	<u>\$ 570,012</u>	<u>\$ 424,556</u>	<u>\$ 4,376,007</u>

CLASSROOM, INC.

Statements of Cash Flows

	<u>Year Ended June 30,</u>	
	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (1,075,988)	\$ (873,830)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and amortization	44,222	110,411
Net realized and unrealized losses on investments		266,389
Donated security	(1,085)	(179,842)
Changes in:		
Pledges receivable	155,544	317,136
Fees and other receivables	159,402	89,195
Product inventories	(80,452)	118,573
Prepaid expenses and other assets	(9,059)	(9,834)
Accounts payable and accrued expenses	32	(128,518)
Deferred revenue	(29,209)	5,797
Net cash used in operating activities	<u>(836,593)</u>	<u>(284,523)</u>
Cash flows from investing activities:		
Purchases of investments		(230,595)
Proceeds from sales of investments	1,085	2,567,753
Purchases of property and equipment	(35,283)	(27,834)
Restricted cash equivalent		<u>(209,503)</u>
Net cash (used in) provided by investing activities	<u>(34,198)</u>	<u>2,099,821</u>
Net change in cash and cash equivalents	(870,791)	1,815,298
Cash and cash equivalents - beginning of year	<u>3,079,493</u>	<u>1,264,195</u>
Cash and cash equivalents - end of year	<u>\$ 2,208,702</u>	<u>\$ 3,079,493</u>

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

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 at the dates acquired to be cash equivalents.

[5] Investments:

Investment transactions are recorded on a trade-date basis, and investments are reported in the accompanying financial statements at their quoted fair values. Donated securities are recorded at their fair values on the dates of the gifts and are generally sold immediately upon receipt by CI.

Realized and unrealized gains and losses are determined by a comparison of specific costs of investments at acquisition to the proceeds at the time of disposal, or to their fair values at year-end, and are reflected in the accompanying statements of activities. Interest and dividend income, as well as realized and unrealized appreciation or depreciation in investment values, are recognized as unrestricted, temporarily restricted or permanently restricted, in accordance with donors' intentions.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

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

[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.

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, 2010 and 2009, 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 "direct support to schools" 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.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

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

[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 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 D 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 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."

(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 functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services in reasonable ratios determined by management.

[12] Income tax uncertainties:

In fiscal-year 2010, CI adopted the provisions of Accounting Standards Codification ("ASC") 740-10-05 relating to accounting and reporting for uncertainty in income taxes. Due to CI's general tax-exempt status, the adoption of ASC 740-10-05 has not had, and is not expected to have, a material impact on CI's financial statements.

[13] Endowment funds:

CI reports all applicable disclosures to its donor-restricted funds treated as endowment (see Note F).

[14] Fair-value of financial instrument measurement:

CI reports all applicable financial assets and liabilities at amounts which approximate their fair values.

[15] Subsequent events:

CI considers the accounting treatments, and the related disclosures in the current fiscal-year's financial statements, that may be required as the result of all events or transactions that occur after the fiscal year-end through the date of the independent auditors' report.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

NOTE B - PLEDGES RECEIVABLE AND FEES AND OTHER RECEIVABLES

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

	June 30,	
	<u>2010</u>	<u>2009</u>
Less than one year	\$ 438,751	\$ 441,001
Two to five years	<u>41,000</u>	<u>200,000</u>
	479,751	641,001
Reduction of pledges due in excess of one year to present value, using rates ranging from 1% to 5%	<u>305</u>	<u>6,011</u>
	<u>\$ 479,446</u>	<u>\$ 634,990</u>

[2] As of June 30, 2010 and 2009, CI's fees and other receivables due from New York City school districts represented approximately 14% and 19%, respectively, of its total fees and other receivables.

NOTE C - PROPERTY AND EQUIPMENT

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

	June 30,	
	<u>2010</u>	<u>2009</u>
Leasehold improvements	\$ 580,006	\$ 584,815
Equipment	262,252	285,538
Donated furniture and fixtures	<u>1,200</u>	<u>1,200</u>
	843,458	871,553
Less accumulated depreciation and amortization	<u>793,526</u>	<u>812,682</u>
	<u>\$ 49,932</u>	<u>\$ 58,871</u>

There were \$63,379 of fully depreciated assets disposed of and written off during fiscal-year 2010.

NOTE D - 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 each fiscal year-end.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

NOTE E - TEMPORARILY RESTRICTED NET ASSETS

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

	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Purpose-restricted:		
Direct support to schools:		
New York	\$ 295,960	\$ 621,184
National Urban Districts		75,000
Research	57,214	41,397
Curriculum development:		
Publishing	137,579	34,606
Product Technology	<u>64,367</u>	
	555,120	772,187
Time-restricted	<u>102,698</u>	<u>234,553</u>
	<u>\$ 657,818</u>	<u>\$ 1,006,740</u>

At June 30, 2010 and 2009, respectively, approximately \$479,000 and \$633,000 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>2010</u>	<u>2009</u>
Purpose-restricted:		
Program restrictions satisfied:		
New York	\$ 549,110	\$ 658,142
National Urban Districts	75,000	9,990
Research and assessment	111,418	56,414
Curriculum development satisfied:		
Publishing	163,003	112,393
Product Technology	<u>59,544</u>	<u>6,527</u>
	958,075	843,466
Time restrictions satisfied	<u>146,553</u>	<u>432,500</u>
	<u>\$1,104,628</u>	<u>\$ 1,275,966</u>

NOTE F - ENDOWMENT

[1] **The Endowment:**

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 endowment.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

NOTE F- ENDOWMENT (CONTINUED)

[2] Interpretation of Relevant Law:

The Board of Directors has interpreted the New York State Uniform Management of Institutional Funds Act ("UMIFA") 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 net assets:

- the original value of gifts donated to the permanent endowment,
- the original value of subsequent gifts 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.

[3] Changes in Endowment Net Assets, for fiscal-year June 30, 2010:

There were no changes in the endowment net assets during fiscal-year 2010. At June 30, 2010, the endowment net assets were held by CI in a money-market account.

[4] Funds with deficiencies:

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UMIFA requires CI to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were approximately \$40,000 as of June 30, 2009. These deficiencies resulted from unfavorable market fluctuations that occurred during fiscal-year 2009. There were no such deficiencies at June 30, 2010.

[5] 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.

[6] Strategies employed for achieving objectives:

Due to continuing volatile market conditions, CI had 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).

[7] Spending policy:

CI has no formal spending policy.

NOTE G - DONATED GOODS AND SERVICES

CI recorded revenues and corresponding expenses or product inventories for donated printing services and donated legal services during fiscal-years 2010 and 2009, which are reported in the accompanying financial statements at their estimated fair values.

CLASSROOM, INC.

Notes to Financial Statements June 30, 2010 and 2009

NOTE G - 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 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 2010 and 2009 were approximately \$64,000 and \$85,000, respectively.

NOTE I - CONCENTRATION OF CREDIT RISK

CI maintains its cash and cash equivalents with two financial institutions, in accounts the balances of which, from time to time, may exceed federally insured limits. CI has not experienced any losses in such accounts, and management believes that CI is not exposed to any significant risk of loss due to the failure of the financial institutions.

NOTE J - 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:

Year Ending June 30,	Amount
2011	\$ 566,542
2012	580,705
2013	595,223
2014	621,780
2015	649,002
Thereafter	<u>2,399,755</u>
	<u>\$ 5,413,007</u>

Rent expense was approximately \$566,000 and \$517,000 for fiscal-years 2010 and 2009, respectively.