

Classroom, Inc.

Financial Statements

June 30, 2017 and 2016

Independent Auditors' Report

Board of Directors Classroom, Inc.

We have audited the accompanying financial statements of Classroom, Inc. ("CI"), which comprise the statements of financial position as of June 30, 2017 and 2016, 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 auditors' 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, 2017 and 2016, 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.

PKF O'Connor Davies, LLP

October 23, 2017

Classroom, Inc.

Statements of Financial Position

	June 30	
	<u>2017</u>	<u>2016</u>
ASSETS		
Cash	\$ 3,146,685	\$ 2,838,257
Pledges receivable, net	988,095	1,169,254
Fees and other receivables, net	51,012	178,437
Product inventories	56,370	279,397
Prepaid expenses and other assets	184,081	174,390
Endowment cash equivalent	250,000	250,000
Property and equipment, net	12,170	46,134
Product development, net	<u>2,328,576</u>	<u>1,883,587</u>
	<u>\$ 7,016,989</u>	<u>\$ 6,819,456</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 246,510	\$ 205,363
Deferred rent payable	-	7,403
Deferred revenue	-	<u>23,568</u>
	<u>246,510</u>	<u>236,334</u>
Net Assets		
Unrestricted	5,142,772	4,342,510
Temporarily restricted	1,377,707	1,990,612
Permanently restricted	<u>250,000</u>	<u>250,000</u>
Total Net Assets	<u>6,770,479</u>	<u>6,583,122</u>
	<u>\$ 7,016,989</u>	<u>\$ 6,819,456</u>

See notes to financial statements

Classroom, Inc.

Statements of Activities

	Year Ended June 30							
	2017				2016			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE								
Contributions								
Individuals	\$ 343,414	\$ 377,440	\$ -	\$ 720,854	\$ 539,176	\$ 678,087	\$ -	\$ 1,217,263
Foundations and trusts	908,803	1,005,626	-	1,914,429	802,576	1,798,940	-	2,601,516
Corporations	10,598	14,028	-	24,626	26,433	100,043	-	126,476
Special events, net of direct cost of \$254,467								
of which \$104,100 was In-Kind services	2,086,708	-	-	2,086,708	-	-	-	-
NYS Education Department	-	258,892	-	258,892	-	231,865	-	231,865
Donated goods and services	179,969	-	-	179,969	50,768	-	-	50,768
Fees	26,525	-	-	26,525	143,860	-	-	143,860
Interest and dividends	4,122	-	-	4,122	4,436	-	-	4,436
Other revenue	10,124	-	-	10,124	1,984	-	-	1,984
Net assets released from restrictions	2,268,891	(2,268,891)	-	-	3,192,834	(3,192,834)	-	-
Total Support and Revenue	<u>5,839,154</u>	<u>(612,905)</u>	<u>-</u>	<u>5,226,249</u>	<u>4,762,067</u>	<u>(383,899)</u>	<u>-</u>	<u>4,378,168</u>
EXPENSES								
Educational Programs								
Direct support to schools	2,211,918	-	-	2,211,918	2,028,940	-	-	2,028,940
Curriculum development	851,795	-	-	851,795	1,062,262	-	-	1,062,262
Research and assessment	405,640	-	-	405,640	349,775	-	-	349,775
Total Educational Programs	3,469,353	-	-	3,469,353	3,440,977	-	-	3,440,977
Management and general	913,841	-	-	913,841	883,709	-	-	883,709
Fundraising	655,698	-	-	655,698	566,480	-	-	566,480
Total Expenses	<u>5,038,892</u>	<u>-</u>	<u>-</u>	<u>5,038,892</u>	<u>4,891,166</u>	<u>-</u>	<u>-</u>	<u>4,891,166</u>
Change in Net Assets	800,262	(612,905)	-	187,357	(129,099)	(383,899)	-	(512,998)
NET ASSETS								
Beginning of year	<u>4,342,510</u>	<u>1,990,612</u>	<u>250,000</u>	<u>6,583,122</u>	<u>4,471,609</u>	<u>2,374,511</u>	<u>250,000</u>	<u>7,096,120</u>
End of year	<u>\$ 5,142,772</u>	<u>\$ 1,377,707</u>	<u>\$ 250,000</u>	<u>\$ 6,770,479</u>	<u>\$ 4,342,510</u>	<u>\$ 1,990,612</u>	<u>\$ 250,000</u>	<u>\$ 6,583,122</u>

See notes to financial statements

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2017

	Educational Programs				Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment	Total Educational Programs			
Salaries and benefits	\$ 725,303	\$ 197,307	\$ 174,179	\$ 1,096,789	\$ 605,648	\$ 283,485	\$ 1,985,922
Professional fees	480,336	69,297	55,078	604,711	37,170	162,604	804,485
Subcontractors	200,322	-	-	200,322	-	-	200,322
Donated legal services	-	-	-	-	92,329	-	92,329
Audit	-	-	-	-	29,209	-	29,209
Occupancy fees	306,302	174,420	99,019	579,741	79,013	131,376	790,130
Office expenses	27,388	7,923	5,724	41,035	5,338	7,571	53,944
Communications	6,926	3,188	1,805	11,919	2,768	2,511	17,198
Repairs and maintenance	6,502	3,324	2,693	12,519	8,452	2,509	23,480
Depreciation and amortization	14,794	8,430	4,772	27,996	3,818	6,364	38,178
Amortization	-	330,236	-	330,236	-	-	330,236
Product supplies	27,228	-	21,176	48,404	-	-	48,404
Travel and conferences	56,409	4,179	5,773	66,361	214	16,126	82,701
Donated printing services	61,159	3,591	9,354	74,104	1,627	12,890	88,621
Temporary help	8,865	-	-	8,865	3,640	-	12,505
Recruiting and hiring	43,257	17,828	10,093	71,178	8,074	13,459	92,711
Insurance	6,238	3,555	2,012	11,805	1,610	2,684	16,099
Fees	12,740	24,845	9,111	46,696	25,202	5,190	77,088
Writeoff of product supply inventory	215,070	-	-	215,070	-	-	215,070
Software support	1,062	605	2,918	4,585	7,343	457	12,385
Other	12,017	3,067	1,933	17,017	2,386	8,472	27,875
	<u>\$ 2,211,918</u>	<u>\$ 851,795</u>	<u>\$ 405,640</u>	<u>\$ 3,469,353</u>	<u>\$ 913,841</u>	<u>\$ 655,698</u>	<u>\$ 5,038,892</u>

See notes to financial statements

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2016

	Educational Programs			Total Educational Programs	Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment				
Salaries and benefits	\$ 878,858	\$ 287,114	\$ 178,525	\$ 1,344,497	\$ 512,763	\$ 296,771	\$ 2,154,031
Professional fees	348,528	89,542	63,996	502,066	53,064	115,730	670,860
Subcontractors	194,078	-	-	194,078	-	-	194,078
Donated legal services	-	-	-	-	9,487	-	9,487
Audit	15,827	5,755	2,878	24,460	4,317	-	28,777
Occupancy fees	277,464	142,319	63,234	483,017	160,586	95,712	739,315
Office expenses	27,909	7,025	3,857	38,791	11,821	7,156	57,768
Communications	7,501	3,023	1,384	11,908	3,612	2,064	17,584
Repairs and maintenance	6,506	3,039	2,158	11,703	5,300	2,162	19,165
Depreciation and amortization	21,715	7,896	3,948	33,559	5,922	-	39,481
Amortization	-	448,918	-	448,918	-	-	448,918
Product supplies	55,202	-	11,304	66,506	-	-	66,506
Travel and conferences	70,745	13,840	6,033	90,618	2,979	14,411	108,008
Donated printing services	15,707	-	-	15,707	15,308	10,266	41,281
Temporary help	8,654	-	-	8,654	57,070	-	65,724
Recruiting and hiring	57,713	11,788	5,576	75,077	17,098	8,417	100,592
Insurance	8,313	3,023	1,511	12,847	2,268	-	15,115
Fees	26,610	34,687	1,957	63,254	7,828	4,704	75,786
Software support	3,347	2,057	3,265	8,669	2,055	1,024	11,748
Other	4,263	2,236	149	6,648	12,231	8,063	26,942
	<u>\$ 2,028,940</u>	<u>\$ 1,062,262</u>	<u>\$ 349,775</u>	<u>\$ 3,440,977</u>	<u>\$ 883,709</u>	<u>\$ 566,480</u>	<u>\$ 4,891,166</u>

See notes to financial statements

Classroom, Inc.

Statements of Cash Flows

	Year Ended	
	June 30	
	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 187,357	\$ (512,998)
Adjustments to reconcile change in net assets to net cash from operating activities		
Writeoff of product supply inventory	215,070	-
Depreciation and amortization	368,414	488,399
Donated investments	(339,112)	(99,076)
Deferred rent payable	(7,403)	(41,359)
Changes in operating assets and liabilities		
Pledges receivable	181,159	(159,748)
Fees and other receivables	127,425	99,177
Product inventories	7,957	29,688
Prepaid expenses and other assets	(9,691)	(4,210)
Accounts payable and accrued expenses	41,147	(98,887)
Deferred revenue	(23,568)	(13,713)
Net Cash from Operating Activities	<u>748,755</u>	<u>(312,727)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investments	339,112	99,076
Purchase of property and equipment	(4,214)	(2,845)
Product development costs	(775,225)	(268,257)
Net Cash from Investing Activities	<u>(440,327)</u>	<u>(172,026)</u>
Change in Cash	308,428	(484,753)
CASH		
Beginning of year	<u>2,838,257</u>	<u>3,323,010</u>
End of year	<u>\$ 3,146,685</u>	<u>\$ 2,838,257</u>

See notes to financial statements

Classroom, Inc.

Notes to Financial Statements June 30, 2017 and 2016

1. Organization

Classroom, Inc. ("CI") is a nonprofit organization that helps students in high-poverty communities build literacy and leadership skills. By creating digital learning games and curriculum set in the professional world and supporting educators in creating student-centered classrooms, CI invites students to take charge of their learning.

CI believes that when students take on the leadership role in learning games, they read more closely, think critically, and become better problem solvers. CI research shows that students (especially those struggling with literacy) improve in their reading and writing achievement, find motivation in being the leader, and see the true connection between school and their future.

Tax Status

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 (US 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

Cash and cash equivalents consist of cash on hand, and cash held in checking and savings accounts.

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

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.

CI receives fees from the sale of its products and services to schools and districts. Amounts received in advance, if any, are recorded as deferred revenue until the related product is delivered or the services are performed, at which time they are shown as revenue.

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, 2017 and 2016, 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, 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. Repairs and maintenance costs 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.

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

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

Product Development

During fiscal year 2014, CI completed a project consisting of three web-enabled simulations. During fiscal 2013, CI started to develop *After the Storm*, the first in a suite of middle school-level learning games. During fiscal year 2016, CI developed the second learning game, *Community in Crisis* and began the development of the third learning game, *Vital Signs*. During fiscal 2017, CI continued to develop *Vital Signs*, and began development of a digital platform and educator toolkit. CI capitalizes only direct labor costs associated with the web-enabling and development of these products. 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. As of June 30, 2017 and 2016, accumulated amortization on completed games was \$1,189,629 and \$859,393, respectively.

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. 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 or disclosure. CI is no longer subject to examinations by the applicable taxing jurisdictions for the periods prior to 2014.

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

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

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 23, 2017.

3. Pledges Receivable

Pledges receivable are shown in the accompanying statements of financial position net of discounts to present value. Gross pledges of \$996,911 and \$1,176,133 at June 30, 2017 and 2016, respectively, with payments due in future years, were discounted to present value using a discount rate ranging from 2.4% to 4.5%. Pledge receivables are due as follows at June 30:

	<u>2017</u>	<u>2016</u>
Less than one year	\$ 776,911	\$ 961,133
Two to five years	<u>220,000</u>	<u>215,000</u>
	996,911	1,176,133
Discount to present value	<u>(8,816)</u>	<u>(6,879)</u>
	<u>\$ 988,095</u>	<u>\$ 1,169,254</u>

4. Property and Equipment

Property and equipment consisted of the following at June 30:

	<u>2017</u>	<u>2016</u>
Leasehold improvements	\$ 588,704	\$ 587,507
Equipment, web design and salesforce	239,483	243,530
Furniture and fixtures	<u>1,200</u>	<u>1,200</u>
	829,387	832,237
Accumulated depreciation and amortization	<u>(817,217)</u>	<u>(786,103)</u>
	<u>\$ 12,170</u>	<u>\$ 46,134</u>

There was \$7,064 and \$77,578 of fully depreciated assets disposed of and written off during fiscal years 2017 and 2016.

5. Concentration of Credit Risk and Other

Financial instruments that potentially subject CI to concentrations of credit risk consist principally of receivables, which are expected to be collected in the normal course of business, and cash. CI maintains its cash in bank deposits in one financial institution. At times, these accounts exceeded the federal insurance limits during fiscal 2017 and 2016, and subjected CI to a concentration of credit risk. CI has not experienced any losses in such accounts and believes that it is not exposed to any significant credit risk on uninsured cash.

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

6. Temporarily Restricted Net Assets

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

	2017	2016
Purpose Restricted		
Direct Support to Schools		
New York	\$ 168,729	\$ 619,178
National urban districts	204,751	57,067
Research	92,120	30,507
Curriculum Development		
Product development	212,500	535,476
Capacity building	261,063	634,666
	939,163	1,876,894
Time restricted	438,544	113,718
	\$ 1,377,707	\$ 1,990,612

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:

	2017	2016
Purpose Restricted		
Direct Support to Schools		
New York	\$ 597,121	\$ 746,901
National urban districts	225,442	266,433
Research	157,933	133,268
Curriculum Development		
Product development	800,462	615,259
Capacity building	102,218	986,608
New York State Education Department - 21st Century Community Learning Centers	258,892	231,865
	2,142,068	2,980,334
Time restricted	126,823	212,500
	\$ 2,268,891	\$ 3,192,834

Classroom, Inc.

Notes to Financial Statements June 30, 2017 and 2016

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.

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 years 2017 and 2016. At June 30, 2017, 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

As of June 30, 2017 and 2016, 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).

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

7. Endowment Funds *(continued)*

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. 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 or product inventories for donated printing services and donated legal services during fiscal years 2017 and 2016, which are reported in the accompanying financial statements at their estimated fair values. Contribution of services is recognized if the services rendered (a) create or enhance non-financial assets or (b) require specialized skills that are provided by individuals possessing these skills that would typically need to be purchased if not provided by donation.

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 US 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, 2017 and 2016 were approximately \$66,000 and \$68,000.

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. In addition to base rent, the lease obligates CI to pay a portion of the building's real estate taxes and electricity.

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

2018	\$ 698,904
2019	353,766
	<u>\$ 1,052,670</u>

Classroom, Inc.

Notes to Financial Statements
June 30, 2017 and 2016

10. Commitments (continued)

Rent expense was approximately \$704,000 and \$688,000 for the years ended June 30, 2017 and 2016.

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

2018	\$ 7,377
2019	7,377
2020	<u>7,517</u>
	<u>\$ 22,271</u>

Lease expense under the equipment agreements was \$8,565 and \$11,399 for the years ended June 30, 2017 and 2016.

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