

Classroom, Inc.

Financial Statements

June 30, 2014 and 2013

Independent Auditors' Report

Board of Directors of Classroom, Inc.

We have audited the accompanying financial statements of Classroom, Inc. ("CI"), which comprise the statements of financial position as of June 30, 2014 and 2013, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Classroom, Inc. as of June 30, 2014 and 2013, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

O'Connor Davies, LLP

October 17, 2014

O'CONNOR DAVIES, LLP

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Classroom, Inc.

Statements of Financial Position June 30,

	<u>2014</u>	<u>2013</u>
ASSETS		
Cash and cash equivalents	\$ 4,623,328	\$ 3,606,995
Pledges receivable, net	1,486,355	809,258
Fees and other receivables, net	361,672	313,492
Product inventories	357,078	410,075
Prepaid expenses and other assets	99,266	107,926
Endowment cash equivalent	250,000	250,000
Property and equipment, net	25,633	9,724
Simulation development, net	<u>1,668,567</u>	<u>882,931</u>
	<u>\$ 8,871,899</u>	<u>\$ 6,390,401</u>
 LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 285,880	\$ 274,030
Deferred rent payable	73,896	71,808
Deferred revenue	<u>49,773</u>	<u>61,109</u>
	<u>409,549</u>	<u>406,947</u>
Net Assets		
Unrestricted	4,379,934	4,227,140
Temporarily restricted	3,832,416	1,506,314
Permanently restricted	<u>250,000</u>	<u>250,000</u>
Total Net Assets	<u>8,462,350</u>	<u>5,983,454</u>
	<u>\$ 8,871,899</u>	<u>\$ 6,390,401</u>

See notes to financial statements

Classroom, Inc.

Statements of Activities Years Ended June 30,

	2014				2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE								
Contributions								
Individuals	\$ 502,423	\$ 1,019,062	\$ -	\$ 1,521,485	\$ 1,530,111	\$ 69,914	\$ -	\$ 1,600,025
Foundations and trusts	736,393	3,834,918	-	4,571,311	755,231	1,135,740	-	1,890,971
Corporations	13,530	11,361	-	24,891	16,536	20,451	-	36,987
NYS Education Department	-	220,639	-	220,639	-	-	-	-
Donated goods and services	109,408	-	-	109,408	67,682	-	-	67,682
Fees	292,018	-	-	292,018	384,741	-	-	384,741
Interest and dividends	6,765	-	-	6,765	8,772	-	-	8,772
Other revenue	18,944	-	-	18,944	17,219	-	-	17,219
Net assets released from restrictions	<u>2,759,878</u>	<u>(2,759,878)</u>	<u>-</u>	<u>-</u>	<u>1,043,237</u>	<u>(1,043,237)</u>	<u>-</u>	<u>-</u>
Total Support and Revenue	<u>4,439,359</u>	<u>2,326,102</u>	<u>-</u>	<u>6,765,461</u>	<u>3,823,529</u>	<u>182,868</u>	<u>-</u>	<u>4,006,397</u>
EXPENSES								
Educational Programs								
Direct support to schools	1,959,999	-	-	1,959,999	1,761,106	-	-	1,761,106
Curriculum development	619,144	-	-	619,144	545,568	-	-	545,568
Research and assessment	<u>180,674</u>	<u>-</u>	<u>-</u>	<u>180,674</u>	<u>318,649</u>	<u>-</u>	<u>-</u>	<u>318,649</u>
Total Educational Programs	<u>2,759,817</u>	<u>-</u>	<u>-</u>	<u>2,759,817</u>	<u>2,625,323</u>	<u>-</u>	<u>-</u>	<u>2,625,323</u>
Management and general	948,284	-	-	948,284	691,432	-	-	691,432
Fundraising	<u>578,464</u>	<u>-</u>	<u>-</u>	<u>578,464</u>	<u>591,718</u>	<u>-</u>	<u>-</u>	<u>591,718</u>
Total Expenses	<u>4,286,565</u>	<u>-</u>	<u>-</u>	<u>4,286,565</u>	<u>3,908,473</u>	<u>-</u>	<u>-</u>	<u>3,908,473</u>
Change in Net Assets	152,794	2,326,102	-	2,478,896	(84,944)	182,868	-	97,924
NET ASSETS								
Beginning of year	<u>4,227,140</u>	<u>1,506,314</u>	<u>250,000</u>	<u>5,983,454</u>	<u>4,312,084</u>	<u>1,323,446</u>	<u>250,000</u>	<u>5,885,530</u>
End of year	<u>\$ 4,379,934</u>	<u>\$ 3,832,416</u>	<u>\$ 250,000</u>	<u>\$ 8,462,350</u>	<u>\$ 4,227,140</u>	<u>\$ 1,506,314</u>	<u>\$ 250,000</u>	<u>\$ 5,983,454</u>

See notes to financial statements

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2014

	Educational Programs				Management and General	Fundraising	Total
	Direct Support to Schools	Curriculum Development	Research and Assessment	Total Educational Programs			
EXPENSES							
Salaries and benefits	\$ 946,045	\$ 203,456	\$ 108,978	\$ 1,258,479	\$ 583,975	\$ 322,148	\$ 2,164,602
Professional fees	227,548	36,387	16,903	280,838	42,363	103,107	426,308
Subcontractors	171,313	-	-	171,313	-	-	171,313
Donated legal services	-	-	-	-	95,029	-	95,029
Audit	14,910	5,422	2,711	23,043	4,066	-	27,109
Occupancy fees	273,137	161,572	32,175	466,884	160,789	94,416	722,089
Office expenses	20,827	9,627	6,686	37,140	11,783	8,765	57,688
Communications	13,058	6,987	1,396	21,441	7,086	4,763	33,290
Repairs and maintenance	7,011	3,803	1,437	12,251	11,394	2,254	25,899
Depreciation and amortization	5,068	1,843	921	7,832	1,382	-	9,214
Amortization of Simulation Development	-	138,542	-	138,542	-	-	138,542
Product supplies	109,041	-	413	109,454	-	-	109,454
Travel and conferences	109,833	13,628	717	124,178	2,929	22,026	149,133
Donated printing services	5,371	-	-	5,371	2,322	6,687	14,380
Other	56,837	37,877	8,337	103,051	25,166	14,298	142,515
	<u>\$ 1,959,999</u>	<u>\$ 619,144</u>	<u>\$ 180,674</u>	<u>\$ 2,759,817</u>	<u>\$ 948,284</u>	<u>\$ 578,464</u>	<u>\$ 4,286,565</u>

See notes to financial statements

Classroom, Inc.

Statement of Functional Expenses
Year Ended June 30, 2013

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

See notes to financial statements

Classroom, Inc.

Statements of Cash Flows Years Ended June 30,

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITES		
Change in net assets	\$ 2,478,896	\$ 97,924
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	147,756	12,210
Donated investments	(311,204)	(499,493)
Changes in operating assets and liabilities		
Pledges receivable	(677,097)	(207,827)
Fees and other receivables	(48,180)	(86,738)
Product inventories	52,997	(24,077)
Prepaid expenses and other assets	8,660	48,384
Accounts payable and accrued expenses	11,850	17,077
Deferred rent payable and deferred revenue	<u>(9,248)</u>	<u>59,604</u>
Net Cash from Operating Activities	1,654,430	(582,936)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(25,123)	(1,139)
Proceeds from sale of investments	311,204	499,493
Simulation development costs	<u>(924,178)</u>	<u>(604,024)</u>
Net Cash from Investing Activities	<u>(638,097)</u>	<u>(105,670)</u>
Change in Cash and Cash Equivalents	<u>1,016,333</u>	<u>(688,606)</u>
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>3,606,995</u>	<u>4,295,601</u>
End of year	<u>\$ 4,623,328</u>	<u>\$ 3,606,995</u>

See notes to financial statements

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

1. Organization

Classroom, Inc. ("CI") is a nonprofit educational organization whose mission is to close the academic achievement gap by using technology and the world of work to engage, teach, inspire, and empower middle and high school students. For more than 20 years, CI has created digital learning games that make authentic connections between school, college, and career using a blended learning model. Students take on decision-making roles as professionals in a simulated workplace while improving literacy, 21st century skills, confidence, and engagement. CI also provides educators with professional development to effectively use our programs and leverage technology. CI's learning games are successfully used in school, extended day, afterschool, and summer school environments. As the result of two Gates Foundation grants and support from its Board of Directors and other donors, CI is developing middle school game-based curriculum, with embedded assessments and robust teacher supports, that addresses the call for highly engaging, rigorous literacy programs designed to the Common Core State Standards.

CI is exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code and from state and local taxes under comparable laws.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For financial statement purposes, CI considers highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

Contributions, Fees and Other Receivables

Contributions are recorded as revenue at the time of receipt of the unconditional pledge of cash or other assets. Contributions are considered available for unrestricted use, unless the donors restrict the use thereof based on a time or purpose restriction, either on a temporary or permanent basis. Contributions to be received after one year are discounted at an appropriate interest rate, commensurate with the risk involved.

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

2. Summary of Significant Accounting Policies (continued)

Contributions, Fees and Other Receivables (continued)

CI receives fees for services from school districts and other educational organizations which are recognized as revenue as services are performed, sometimes based on the proportion of direct costs incurred to total estimated direct costs. Fees received in advance are recorded as deferred revenue until the related services are performed.

Donated securities are recorded at fair value at the date of the gift and are generally sold immediately upon receipt by CI.

Interest and dividend income are recognized as unrestricted, temporarily restricted or permanently restricted in accordance with donors' intentions.

CI's management periodically evaluates receivable balances to determine whether an allowance for doubtful accounts should be established to cover amounts determined to be uncollectible. At June 30, 2014 and 2013, no such allowance was considered necessary.

Product Inventories

Product inventories consist primarily of printed learning materials and other educational supplies to be supplied to schools and other educational organizations and are valued at the lower of cost or market value, using the average cost method of valuation.

Costs incurred to ship product inventories to program participants are expensed as incurred. These costs are reported as "direct support to schools" expense in the accompanying statements of activities.

Property and Equipment

Property and equipment are stated at cost at the time of purchase, or at fair value at the date of donation. Leasehold improvements are capitalized, whereas the costs of repairs and maintenance are expensed as incurred.

Depreciation is provided using the straight-line method over the estimated useful lives of the assets, ranging from 3 to 7 years. Leasehold improvements are amortized over the remaining term of the respective lease or the useful life of the improvement, whichever is shorter.

Simulation Development

During fiscal year 2012, CI started a project to web-enable three simulations, which was completed during fiscal year 2014. During fiscal 2013, CI started to develop *After the Storm*, the first in a suite of middle school-level learning games. CI capitalizes only direct labor costs associated with the web-enabling and development of these simulations. Amortization of these costs will commence upon completion of each project using the straight-line method over the estimated useful lives of 3 to 7 years. As of June 30, 2014, accumulated amortization was \$138,542 on those simulations which were completed during fiscal year 2014.

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

2. Summary of Significant Accounting Policies (continued)

Net Asset Presentation

CI reports information regarding its financial position and activities according to three classes of net assets based on donor restrictions: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets represent those resources that are not subject to donor-imposed restrictions and are fully available, at the discretion of the Board of Directors and management, for CI to utilize in any of its programs or supporting services.

Temporarily restricted net assets represent those resources that have been restricted by donors for specific purpose or time frame. When a donor's time-restriction expires or a purpose-restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying statements of activities as "net assets released from restrictions."

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

Functional Allocation of Expenses

The costs of providing the various programs and supporting services have been summarized on a functional basis in the accompanying statements of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services in reasonable ratios determined by management.

Accounting for Uncertainty in Income Taxes

CI recognizes the effect of income tax positions only when they are more likely than not to be sustained. Management has determined that CI had no uncertain tax positions that would require financial statement recognition. CI is no longer subject to examinations by the applicable taxing jurisdictions for the periods prior to 2011.

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 17, 2014.

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

3. Pledges Receivable

Subsequent Events Evaluation by Management (continued)

Pledges receivable are shown in the accompanying statements of financial position net of discounts to present value. Gross pledges of \$1,516,611 and \$818,250 at June 30, 2014 and 2013, with payments due in future years, were discounted to present value using a discount rate ranging from 2.2% to 3.8%. Pledge receivables are due as follows at June 30:

	<u>2014</u>	<u>2013</u>
Less than one year	\$ 816,611	\$ 556,250
Two to five years	<u>700,000</u>	<u>262,000</u>
	1,516,611	818,250
Discount to present value	<u>(30,256)</u>	<u>(8,992)</u>
	<u>\$ 1,486,355</u>	<u>\$ 809,258</u>

4. Property and Equipment

At June 30, 2014 and 2013 property and equipment, net of accumulated depreciation consisted of the following:

	<u>2014</u>	<u>2013</u>
Leasehold improvements	\$ 586,399	\$ 581,649
Equipment	253,899	233,526
Furniture and fixtures	<u>1,200</u>	<u>1,200</u>
	841,498	816,375
Accumulated depreciation	<u>(815,865)</u>	<u>(806,651)</u>
	<u>\$ 25,633</u>	<u>\$ 9,724</u>

There was \$9,960 of fully depreciated assets disposed of and written off during fiscal year 2013. There were no assets disposed during fiscal year 2014.

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.

CI received pledges from three donors to support its fiscal operations and related programs which aggregate to 35% of total support and revenue during fiscal year 2014. Approximately 12% of these pledges are due from these donors over a five year period.

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

6. Temporarily Restricted Net Assets

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

	2014	2013
Purpose restricted		
Direct support to schools		
New York	\$ 399,849	\$ 326,826
National Urban Districts	7,680	23,000
Research	84,012	85,579
Curriculum development		
Simulation Development	1,627,346	160,214
Capacity Building	1,197,647	375,861
	3,316,534	971,480
Time restricted	515,882	534,834
	\$ 3,832,416	\$ 1,506,314

At June 30, 2014 and 2013 approximately \$1,082,000 and \$425,000 of purpose-restricted amounts are also time-restricted.

Net assets were released from donor restrictions during the years ended June 30, which satisfied the restricted purposes specified by the donors or the passage of time as follows:

	2014	2013
Purpose restricted		
Direct support to schools		
New York	\$ 570,939	\$ 376,678
National Urban Districts	61,743	12,381
Research	65,182	100,938
Curriculum development		
Simulation Development	754,060	303,782
Capacity Building	778,605	194,064
New York State Education Department - 21st Century Community Learning Centers	220,639	-
	2,451,168	987,843
Time restricted	308,710	55,394
	\$ 2,759,878	\$ 1,043,237

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

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 year 2014. At June 30, 2014, the endowment net assets were held by CI in a savings account.

Return Objectives and Risk Parameters

CI has adopted an investment approach for endowment assets that attempts to preserve the principal of the endowment assets. Under this approach, as approved by the Board of Directors, the endowment assets are invested in a prudent manner that is intended to preserve the principal, with a moderate rate of return, and a moderate level of investment risk.

Strategies Employed for Achieving Objectives

During fiscal years 2014 and 2013, 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, 2014 and 2013

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. CI's permanent restricted net assets are invested in a savings account. The interest and dividends are transferred to CI's checking account to support general operations.

8. Donated Goods and Services

CI recorded revenues and corresponding expenses or product inventories for donated printing services and donated legal services during fiscal years 2014 and 2013, 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 recognition under U.S. GAAP.

9. Employee Benefit Plan

CI maintains a defined-contribution 403(b) retirement plan (the "Plan") that provides benefits for substantially all of its employees. CI contributes an amount equal to 3% of each eligible participating employee's compensation to the Plan. If an employee also makes contributions to the Plan, CI will match the employee's contributions up to an additional 2% of compensation, as defined by the Plan. The maximum employer contribution is 5%. Contributions to the Plan for the years ended June 30, 2014 and 2013 were approximately \$76,000 and \$64,000.

10. Commitments

CI's non-cancelable operating lease for its office space will expire on December 31, 2018, with an option to renew for an additional five years.

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

2015	\$ 649,002
2016	665,227
2017	681,858
2018	698,904
2019	353,766
	<u>\$ 3,048,757</u>

Classroom, Inc.

Notes to Financial Statements
June 30, 2014 and 2013

10. Commitments (continued)

Rent expense was approximately \$647,000 and \$648,000 for the years ended June 30, 2014 and 2013.

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

2015	\$ 8,815
2016	<u>8,246</u>
	<u>\$ 17,061</u>

Lease expense under the equipment agreements was \$10,678 and \$10,564 for the years ended June 30, 2014 and 2013.

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