Grant Thornton

Consolidated Financial Statements and Report of Independent Certified Public Accountants

MIND RESEARCH INSTITUTE

JUNE 30, 2014

Contents

Audit – Tax – Advisory

Grant Thornton LLP
515 South Flower Street, 7th Floor
Los Angeles, CA 90071-2201

T 213.627.1717
F 213.624.6793
www.GrantThornton.com

Report of Independent Certified Public Accountants

Board of Directors
MIND Research Institute

We have audited the consolidated accompanying financial statements of MIND Research Institute and its subsidiary, which comprise the consolidated statement of financial position as of June 30, 2014, and the related consolidated statement of activities and changes in net assets, consolidated statement of functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of MIND Research Institute as of June 30, 2014, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Los Angeles, California
January 16, 2015

MIND Research Institute

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2014

ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$	432,310
Accounts receivable		3,731,233
Pledges receivable		461,250
Prepaid expenses		378,801
Total Current Assets		5,003,594
FIXED ASSETS		
Equipment, furniture, and leasehold improvements		4,208,218
Less: accumulated depreciation		(1,832,598)
Total Fixed Assets, net		2,375,620
OTHER ASSETS		
Pledges receivable, noncurrent		328,013
Deposits		57,142
Intangible assets, net		554,475
Total Other Assets		939,630
TOTAL ASSETS	$	8,318,844
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	$	590,724
Accrued expenses		1,194,423
Line of credit		1,600,000
Deferred revenue, current		3,676,263
Deferred rent, current		34,359
Note payable, current		6,114
Total Current Liabilities		7,101,883
NONCURRENT LIABILITIES		
Deferred revenue, net of current		346,433
Deferred rent, net of current		738,848
Note payable, net of current		42,440
Total Noncurrent Liabilities		1,127,721
NET ASSETS		
Unrestricted		(2,896,165)
Temporarily restricted		2,985,405
Total Net Assets		89,240
TOTAL LIABILITIES AND NET ASSETS	$	8,318,844

See accompanying notes to consolidated financial statements.

MIND Research Institute

CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the year ended June 30, 2014

	Unrestricted	Temporarily Restricted	Total
SUPPORT AND REVENUES			
Contributions	$ 2,050,588	$ 4,507,875	$ 6,558,463
Special events, net	467,237	-	467,237
In-kind revenues	510,090	-	510,090
Total Fundraising and Philanthropy	3,027,915	4,507,875	7,535,790
Program Support-School Sales	18,909,812	-	18,909,812
Gain on sale of securities	232	-	232
Total Other Support	232	-	232
Net Assets Released from Restrictions	2,156,666	(2,156,666)	-
TOTAL SUPPORT AND REVENUES	24,094,625	2,351,209	26,445,834
EXPENSES			
Program	21,896,827	-	21,896,827
Management	1,318,667	-	1,318,667
Fundraising	1,989,950	-	1,989,950
TOTAL EXPENSES	25,205,444	-	25,205,444
CHANGE IN NET ASSETS	(1,110,819)	2,351,209	1,240,390
BEGINNING NET ASSETS (DEFICIT)	(1,785,346)	634,196	(1,151,150)
ENDING NET ASSETS	$ (2,896,165)	$ 2,985,405	$ 89,240

See accompanying notes to consolidated financial statements.

MIND Research Institute

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

For the year ended June 30, 2014

	Program					
Expense	Education	Research	Total	Fundraising	Management	Total
Salaries	$ 13,568,522	$ 311,992	$ 13,880,514	$ 1,244,357	$ 1,053,536	$ 16,178,407
Benefits	1,100,959	33,986	1,134,945	97,148	45,804	1,277,897
Payroll Taxes	921,177	22,180	943,357	86,507	68,752	1,098,616
Labor sub-total	15,590,658	368,158	15,958,816	1,428,012	1,168,092	18,554,920
Travel, Meals & Entertainment	1,426,404	36,313	1,462,717	91,540	13,693	1,567,950
Outside Services	909,006	157,028	1,066,034	113,667	7,659	1,187,360
Facility Costs	987,907	25,274	1,013,181	64,697	36,326	1,114,204
Depreciation & Amortization	542,267	15,588	557,855	40,804	24,299	622,958
Conferences & Meetings	463,349	455	463,804	26,547	2,147	492,498
Office Expenses	392,469	1,254	393,723	9,357	6,612	409,692
Legal	152,688	6,941	159,629	20,488	41,815	221,932
Public Relations & Outreach	202,430	-	202,430	-	-	202,430
Information Technology	167,356	4,119	171,475	11,074	6,573	189,122
Printing & Publishing	129,261	75	129,336	25,516	4,052	158,904
Subscriptions	93,827	11	93,838	38,775	25	132,638
Interest	84,222	2,797	87,019	6,236	3,746	97,001
Special Event-Awards Gala	-	-	-	83,798	-	83,798
Business Insurance	24,348	684	25,032	1,887	456	27,375
Bank Fees	457	4	461	21,339	39	21,839
Accounting	16,613	573	17,186	1,268	886	19,340
Other	93,624	667	94,291	4,945	2,247	101,483
Totals	$ 21,276,886	$ 619,941	$ 21,896,827	$ 1,989,950	$ 1,318,667	$ 25,205,444

See accompanying notes to consolidated financial statements.

MIND Research Institute

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended June 30, 2014

CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	$	1,240,390
Adjustments to reconcile changes in net assets to net cash from operating activities:		
Depreciation and amortization		622,957
Donation of equipment		(498,010)
Loss on disposal of equipment		20,175
(Increase) decrease in assets:		
Accounts receivable		(1,881,867)
Pledge receivables		(162,170)
Prepaid expenses		(295,039)
Deposits		23,402
Increase (decrease) in liabilities:		
Accounts payable		292,599
Accrued expenses		485,322
Deferred revenues		538,937
Deferred rent		(25,292)
Net Cash From Operating Activities		361,404
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of fixed assets		(306,687)
Acquisition of intangible assets		(103,826)
Net Cash From Investing Activities		(410,513)
CASH FLOWS FROM FINANCING ACTIVITIES		
Line of credit (net)		703
Issuance of note payable		48,554
Net Cash From Investing Activities		49,257
NET INCREASE IN CASH AND CASH EQUIVALENTS		148
BEGINNING CASH AND CASH EQUIVALENTS		432,162
ENDING CASH AND CASH EQUIVALENTS	$	432,310
SUPPLEMENTARY INFORMATION		
Interest paid	$	97,002
Income taxes paid		NONE

See accompanying notes to consolidated financial statements.

NOTE 1 – ORGANIZATION

The MIND Research Institute (the "Organization") is a nonprofit tax exempt organization which was incorporated in April 1998. The Organization's mission is to ensure that all students are mathematically equipped to solve the world's most challenging problems through developing and deploying math instructional software and systems. A non-profit organization, MIND also conducts basic neuroscientific, mathematics, and education research to improve math education and advance scientific understanding.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Principles of Consolidation

The consolidated financial statements include the accounts of the MIND Research Institute and MIND Education, Inc., a 98% owned subsidiary, and are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. For the year ended June 30, 2014, MIND Education, Inc. had no assets and no activity. All intercompany amounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Organization reports information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets. Net assets that are not subject to donor imposed restrictions and that may be expendable for any purpose in performing the primary objectives of the Organization.

Temporarily restricted net assets. Net assets that are subject to donor-imposed stipulations that can be fulfilled by actions of the Organization pursuant to those stipulations or that expire by the passage of time. Temporarily restricted resources whose restrictions are met in the same reporting period are recorded as unrestricted.

Permanently restricted net assets. Net assets that are subject to donor-imposed stipulations that they be maintained permanently by the Organization. As of June 30, 2014, the Organization did not have any permanently restricted net assets.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

For the purpose of the consolidated statement of cash flows, the Organization considers cash on hand and cash in other depository institutions with an original maturity of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable result from the sales of educational programs. The Organization's policy is to provide an allowance for doubtful accounts, when necessary, to reflect estimated uncollectible accounts. No allowance for doubtful accounts has been provided as management believes all amounts are collectible.

Pledges Receivable

Unconditional promises to give are recognized in the period received and when collectability is reasonably assured. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional. Pledges to be received in more than one year are discounted to net present value based on the *Wall Street Journal* prime rate.

No allowance for uncollectible amounts has been established as management believes all pledges receivable to be fully collectible.

Equipment, Furniture, and Leasehold Improvements

Equipment, furniture, and leasehold improvements are carried at cost or, if donated, at the approximate fair value on the date of donation. Depreciation is provided on the straight-line method over estimated useful lives. The useful lives of equipment and furniture are estimated to range between five and seven years, and leasehold improvements are estimated to be the lesser of the lease term or economic life. Additions and improvements that increase the capacity or lengthen the useful lives of the assets are capitalized. Repairs and maintenance are expensed as incurred.

Intangible Assets

Patent, trademark and copyright application costs are capitalized. When patents are approved, they are amortized on a straight-line basis over their expected lives. Indefinite lived intangible assets are evaluated for impairment on at least an annual basis. There was no impairment of intangible assets during the year.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue and Support

Revenue primarily consists of contributions and sales of educational software, subscriptions and related support and training services.

The Organization's software sales consist of multiple elements of the above items. Revenue earned on software arrangements involving multiple elements is allocated to each element based on the relative fair values of those elements. The fair value of an element is based on vendor-specific objective evidence ("VSOE"). The Organization limits its assessment of VSOE of fair value for each element to the price charged when the same element is sold separately. VSOE calculations are updated annually. The Organization establishes VSOE of fair value for the related undelivered elements based on the bell-shaped curve method, where the entire population of separate transactions where the element is sold separately is evaluated to determine whether the range of prices paid is sufficiently narrow to provide evidence of VSOE of fair value.

The Organization derives revenue from subscription fees for access to and use of its math education system. Subscription fees are recognized ratably over the contract term of the arrangement beginning on the date that the subscription is made available to the customer.

When evidence of fair value exists for the undelivered elements only, the residual method is used. Under the residual method, the Organization defers revenue related to the undelivered elements based on VSOE of fair value of each of the undelivered elements and allocates the remainder of the contract price net of all discounts to revenue recognized from the delivered elements.

The Organization estimates that the majority of the deferred revenue as of June 30, 2014 will be recognized as revenue over the subsequent 12 months.

The Organization ensures that the following criteria are met prior to recognition of revenue: there is persuasive evidence of an arrangement; the product has been delivered or services have been rendered; the fee is fixed or determinable; and collectability is reasonably assured.

Contributions are recognized when the donor makes a promise to give that is, in substance, unconditional. All contributions are considered to be unrestricted unless specifically restricted by the donor.

Donated Services and Goods

The Organization recognizes the contribution of services if the services received require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Contributed services that do not meet the criteria shall not be recognized.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Donated goods are recorded as contributions at their estimated fair value on the date of donation. Such donations are reported as increases in unrestricted net assets unless the donor has restricted the donated goods to a specific purpose.

Functional Allocation of Expenses

The costs of providing the various programs and activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited based on estimates developed by management.

Computer Software Development Costs

All computer software development costs are considered research and development activities and are expensed as incurred.

Income Tax Status

The Organization is exempt from income taxes under Internal Revenue Code Section 501(c)(3) and California Revenue Code Section 23701(d). The Organization is classified by the Internal Revenue Service as an entity that is not a private foundation within the meaning of Section 509(a) and qualifies for deductible contributions as provided in Section 170(c)(2). Income for certain activities not directly related to the Organization's tax-exempt purpose is subject to unrelated business income taxation.

The Organization evaluates uncertain tax positions whereby the effect of the uncertainty would be recorded if the tax positions will more likely than not be sustained upon examination. As of June 30, 2014, management does not believe the Organization has any uncertain tax positions requiring accrual or disclosure. The Organization is subject to potential income tax audits on open tax years by any taxing jurisdiction in which it operates. The statute of limitations for federal and California state purposes is generally three and four years, respectively.

Reporting of Subsequent Events

In preparing these consolidated financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through January 16, 2015, the date the financial statements were available to issue.

NOTE 3 – FAIR VALUE MEASUREMENTS

The carrying value of cash and cash equivalents are reasonable estimates of fair value due to their short term nature.

NOTE 4 – PLEDGES RECEIVABLE

Pledges receivable as of June 30, 2014 are as follows:

Receivable in less than one year	$ 461,250
Receivable in one to five years	367,500
	828,750
Less: present value discounts	(39,487)
	789,263
Less: current portion	(461,250)
Noncurrent portion	$ 328,013

NOTE 5 – EQUIPMENT, FURNITURE, AND LEASEHOLD IMPROVEMENTS

A summary of equipment, furniture, and leasehold improvements as of June 30, 2014 is as follows:

Equipment	$ 2,912,970
Furniture	351,347
Leasehold improvements	943,901
	4,208,218
Less: accumulated depreciation	(1,832,598)
	$ 2,375,620

For the year ended June 30, 2014, depreciation expense recognized was $588,441.

NOTE 6 – INTANGIBLE ASSETS

A summary of intangible assets as of June 30, 2014 is as follows:

Patent costs	$ 466,157
Trademarks and copyrights	146,728
	612,885
Less: accumulated amortization	(58,410)
	$ 554,475

For the year ended June 30, 2014, amortization expense recognized was $34,516. The weighted average remaining useful lives of the Organization’s amortizing intangible assets is 108 months. The estimated future amortization expense related to intangible assets will be approximately $15,000 per year from fiscal 2015 to 2019.

NOTE 7 – NOTE PAYABLE

During January 2013, the Organization acquired a note payable ("the note") to finance tenant improvements to its office facility. The note is collateralized by the Organization's assets and matures in December 2020. The note bears an annual interest rate of 7 percent. As of June 30, 2014, the outstanding balance on the note was $48,554. For the year ended June 30 2014, the Organization incurred interest expense and fees of $5,572. Subsequently, the note was paid in full on September 24, 2014.

NOTE 8 – LINE OF CREDIT

During May 2014, the Organization renewed its line of credit with a financial institution for up to $3,700,000. The line of credit is collateralized by the Organization's assets and matures in June 2015. The line of credit bears a variable interest rate based on the *Wall Street Journal* prime rate plus one percent, with a minimum rate of 5.75 percent. As of June 30, 2014, the line of credit's interest rate was 5.75 percent. The line of credit requires minimum monthly payments on interest incurred and requires payment of all outstanding balances upon maturity. The line of credit contains customary affirmative and negative covenants. As of June 30, 2014, the Organization believes it was in compliance with all covenants. As of June 30, 2014 there was $1,600,000 outstanding under this line of credit. For the year ended June 30, 2014 the Organization incurred interest expense and fees of $91,227.

NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following as of June 30, 2014:

Time restricted	$ 543,155
Purpose restricted	2,442,250
	$ 2,985,405

Net assets were released from donor restrictions either by incurring expenses, which satisfied the restricted purposes or by the occurrences of other events specified by donors during the year ended June 30, 2014.

NOTE 10 – SPECIAL EVENTS

The Organization conducts special events in order to raise funds to support operations and various programs. Revenues and donor benefit expenses relating to special events for the year ended June 30, 2014 are as follows:

Revenues	$ 522,661
Less direct donor benefits	(55,424)
	$ 467,237

NOTE 11 – IN-KIND GOODS AND SERVICES

Many individuals volunteer their time and perform a variety of tasks that assist the Organization. For the year ended June 30, 2014, no amounts have been recognized in the statement of activities as they have not met the criteria described in Note 2.

The Organization receives donated materials, equipment, and storage space. For the year ended June 30, 2014, the Organization recognized in-kind revenues of $510,090.

NOTE 12 – RELATED PARTY TRANSACTIONS

For the year ended June 30, 2014, the Organization received contributions from members of the Organization's board of directors or business or charitable entities related to them totaling $786,805.

Pledges receivable from the Organization's board of directors or business or charitable entities related to them are as follows as of June 30, 2014:

Related party pledges receivable, current	$ 82,500
Related party pledges receivable, noncurrent	282,686
	$ 365,186

The Organization was provided with inventory storage space by an entity owned by a member of the Organization's board of directors. For the year ended June 30, 2014, the Organization recognized in-kind rent of $12,080.

NOTE 13 – LEASE COMMITMENT

During September 2012, the Organization entered into a lease agreement for office space located in Irvine, California beginning in January 2013. The term of the lease extends through December 2020 and requires minimum monthly rent payments of $50,056. The lease includes certain tenant improvements and rent abatement during the lease period. As of June 30, 2014, the Organization recorded deferred rent of $773,207. The Organization also leases a storage facility and office equipment with maturities ranging from August 2014 to March 2018.

For the year ended June 30, 2014, rent expense was $887,074.

Future minimum lease payments for the years ending June 30 are as follows:

Year Ended June 30,	
2015	$ 795,743
2016	821,055
2017	807,487
2018	808,422
2019 and after	1,972,680
	$ 5,205,387

NOTE 14 – CONCENTRATION OF CREDIT RISK

For the year ended June 30, 2014, the Organization received 28 percent of its revenue from its fundraising activities. Management anticipates continued support from its contributors in the future to be a substantial portion of the Organization’s revenue.

Cash deposits in financial institutions may exceed federally insured limits at times during the year. As of June 30, 2014, the cash and cash equivalents held at financial institutions in excess of the Federal Deposit Insurance Corporation insurance amount of $250,000 was approximately $156,000. Cash deposited in financial institutions differs from cash presented in the consolidated statement of financial position due to timing differences.