



Challenger Center for Space Science Education

Audited Financial Statements

*Years ended June 30, 2005 and 2004
with Report of Independent Auditors*

Challenger Center for Space Science Education

Audited Financial Statements

Years ended June 30, 2005 and 2004

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Report of Independent Auditors

Board of Directors
Challenger Center for Space Science Education
Alexandria, Virginia

We have audited the accompanying statements of financial position of Challenger Center for Space Science Education (Challenger Center) as of June 30, 2005 and 2004, and the related statements of activities, and cash flows for the years then ended. These financial statements are the responsibility of Challenger Center'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 Challenger Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Challenger Center for Space Science Education at June 30, 2005 and 2004, and the changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Johnson Lambert & Co.

Reston, Virginia
September 26, 2005

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Challenger Center for Space Science Education

Statements of Financial Position

	June 30,	
	2005	2004
Assets		
Cash and cash equivalents	\$ 450,308	\$ 170,107
Accounts receivable, net of allowance of \$50,800 and \$27,000 at 2005 and 2004, respectively	257,609	222,334
Pledges receivable, net of discount	671,350	985,969
Grants receivable	111,299	38,125
Prepaid expenses and deposits	78,540	125,309
Inventory	56,100	77,827
Property, land and equipment, net	547,650	3,982,308
Beneficial interest in trust fund	15,873,942	15,900,136
Total assets	\$ 18,046,798	\$ 21,502,115
Liabilities and net assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 824,378	\$ 1,372,566
Deferred learning center revenue	375,000	47,500
Deferred revenue, other	126,076	82,590
Deferred gain on sale of building	1,880,011	-
Line of credit	-	200,000
Notes payable	150,000	165,675
Deed of trust note	-	3,688,388
Total liabilities	3,355,465	5,556,719
Net assets (deficit):		
Unrestricted net assets	(2,307,102)	(1,473,677)
Temporarily restricted net assets	1,124,493	1,518,937
Permanently restricted net assets	15,873,942	15,900,136
Total net assets	14,691,333	15,945,396
Total liabilities and net assets	\$ 18,046,798	\$ 21,502,115

See accompanying notes to the financial statements.

Challenger Center for Space Science Education

Statements of Activities

	Years ended June 30,	
	2005	2004
Change in unrestricted net assets		
Revenue:		
NASA trust fund	\$ 1,000,000	\$ 1,000,000
Federal grants	729,082	778,258
Learning centers	750,147	3,096,980
Contributions and sponsorships	335,186	801,043
Realized gain on sale of building	208,890	-
Educational program income	165,000	194,605
Other income	164,222	53,653
Donated materials and services	-	157,138
	3,352,527	6,081,677
Net assets released from restriction	541,243	190,832
Total unrestricted revenue	3,893,770	6,272,509
 Expenses:		
Program services:		
Learning centers	1,618,315	2,927,557
Education programs	1,735,602	1,770,099
CLCGW	397,682	502,037
Public awareness	237,173	356,395
	3,988,772	5,556,088
 Supporting services:		
Management and general	660,708	542,944
Fundraising	77,706	318,588
	738,414	861,532
Total expenses	4,727,186	6,417,620
 Change in unrestricted net assets	\$ (833,416)	\$ (145,111)

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Challenger Center for Space Science Education

Statements of Activities (Continued)

	Years ended June 30,	
	<u>2005</u>	<u>2004</u>
Change in temporarily restricted net assets		
Contributions	\$ 146,790	\$ 1,147,054
Net assets released from restrictions	<u>(541,243)</u>	<u>(190,832)</u>
Change in temporarily restricted net assets	(394,453)	956,222
Change in permanently restricted net assets		
Change in fair value of beneficial interest in trust fund	<u>(26,194)</u>	<u>(26,195)</u>
Change in permanently restricted net assets	<u>(26,194)</u>	<u>(26,195)</u>
Net change in net assets	(1,254,063)	784,916
Net assets, beginning of year	<u>15,945,396</u>	<u>15,160,480</u>
Net assets, end of year	<u>\$ 14,691,333</u>	<u>\$ 15,945,396</u>

See accompanying notes to the financial statements.

Challenger Center for Space Science Education

Statements of Cash Flows

	Years ended June 30,	
	2005	2004
Cash flow from operating activities		
Net change in net assets	\$ (1,254,063)	\$ 784,916
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	134,240	284,768
Loss on disposal of fixed assets	15,545	-
Trust fund premium amortization	26,194	26,195
Gain on sale of building	(208,890)	-
Changes in certain assets and liabilities:		
Accounts receivable	(35,275)	186,974
Grants receivable	(73,174)	85,579
Pledges receivable, net of discount	314,619	(607,225)
Inventory	21,727	(3,125)
Prepaid expenses and deposits	46,769	(6,104)
Accounts payable and accrued expenses	(548,188)	(259,703)
Deferred learning center revenue	327,500	(228,548)
Deferred revenue, other	43,486	(13,070)
Deferred gain on sale of building	1,880,011	-
Net cash provided by operating activities	690,501	250,657
Cash flow from investing activities		
Purchases of property, land and equipment	(16,183)	(65,080)
Net proceeds from sale of property, land and equipment	3,509,946	-
Net cash provided by (used in) investing activities	3,493,763	(65,080)
Cash flows from financing activities		
Payments on mortgage payable	(3,688,388)	(60,091)
Payments on notes payable	(15,675)	(15,675)
Payments on line of credit	(200,000)	-
Net cash used in financing activities	(3,904,063)	(75,766)
Net change in cash and cash equivalents	280,201	109,811
Cash and cash equivalents, beginning of year	170,107	60,296
Cash and cash equivalents, end of year	\$ 450,308	\$ 170,107
Supplemental cash flow information		
Cash paid during the year for interest	\$ 18,302	\$ 275,543

See accompanying notes to the financial statements.

Challenger Center for Space Science Education

Notes to Financial Statements

Years ended June 30, 2005 and 2004

Note A - Summary of Significant Accounting Policies

Organization

Challenger Center for Space Science Education ("Challenger Center") is a not-for-profit, charitable organization incorporated in 1986. Challenger Center was formed to operate facilities and programs necessary to help students develop scientific, problem-solving skills and overcome illiteracy in the field of science and technology.

Income Tax Status

Challenger Center is exempt from income taxes on its exempt activities under Section 501(c)(3) of the Internal Revenue Code.

Basis of Accounting and Use of Estimates

Challenger Center prepares its financial statements on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Consequently, revenue is recognized when earned and expenses are recognized when obligations are incurred. The preparation of financial statements prepared in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The actual results could differ from the estimates.

Cash and Cash Equivalents

For financial statement purposes, Challenger Center considers all demand deposits and money market funds to be cash equivalents.

Inventory

Inventory consists of education products and programs for resale and Learning Center supplies and is stated at the lower of cost (first-in, first-out method) or market value.

Property, Land and Equipment

Furniture, fixtures and equipment are recorded at cost, and are depreciated on the straight-line basis over the estimated useful lives (5-7 years) of the related assets. Expenditures related to the Challenger Learning Center of Greater Washington and the building in Alexandria, Virginia are recorded at cost and are depreciated on the straight-line basis over their estimated useful lives (10 and 30 years, respectively). The policy of Challenger Center is to capitalize items greater than \$1,000 and with a useful life greater than 12 months.

Reclassifications

Certain 2004 balances were reclassified to conform to the 2005 presentation.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note A - Summary of Significant Accounting Policies (Continued)

Net Assets

Net assets are classified as either unrestricted, temporarily or permanently restricted and have been classified based on the existence or absence of donor-imposed restrictions. In order to account for limitations placed on the use of resources available to Challenger Center, the accounts are maintained in accordance with the principles of fund accounting. The purpose of each net asset classification is as follows:

Unrestricted net deficit - Used for the general operations of Challenger Center.

Temporarily restricted net assets - Challenger Center receives support to carry out educational programs. Contributions received from donors are restricted for such use. Net assets released from restrictions represent amounts expended in satisfaction of the donor-imposed restrictions.

Permanently restricted net assets - These are comprised of the amortized cost value of certain assets held in trust by the Science, Space, and Technology Education Trust Fund, which is further discussed in Note F.

Recognition of Donor Restricted Support

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are restricted for future periods or specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes.

When a donor stipulated time restriction ends or a purpose restriction is accomplished, the restricted net assets are reclassified to unrestricted net assets and are reported in the statement of activities as net assets released from restriction. Temporarily restricted contributions whose restrictions were satisfied during the year in which they were received have been reported as unrestricted contribution revenue.

Donated Materials and Services

Donated materials and professional services are recorded as contributions and expenses in the accompanying financial statements at their estimated values at date of receipt, provided an objective basis exists to measure the value of such materials and services.

Functional Allocation of Expenses

Expenses are generally allocated to each functional area based on specific identification. Overhead costs and certain management and general expenses are allocated to functional areas based on the ratio of direct salaries included in each area to total salaries.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note B - Long Term Debt

On August 1, 2002, Challenger Center refinanced the total outstanding amount on the bonds used to finance the building purchase at 1250 North Pitt Street and the line of credit with a deed of trust note payable with a financial institution in the amount of \$3,800,000. The interest on the note was the Wall Street Journal Prime plus 1.5% with a floor of 6.75% and a ceiling of 7.75%. Principal and interest were paid monthly based on a twenty-five year amortization schedule with the loan originally maturing on August 1, 2007. The loan was secured by a first lien Deed of Trust on the property located at 1250 North Pitt Street. Additional collateral was provided by the beneficiary interest in the Science, Space and Technology Trust Fund. The building was sold in July 2004, eliminating the loan balance. The amount outstanding on the loan as of June 30, 2005 and 2004 is \$0 and \$3,688,388, respectively. This financial institution also provided a line of credit in the amount of \$200,000, which was also eliminated with the sale of the building in fiscal year 2005. The rate on the line was the Wall Street Journal Prime plus 1.5% with a floor of 6.75% and a ceiling of 7.75%. The amount outstanding on the line of credit as of June 30, 2005 and 2004 is \$0 and \$200,000, respectively.

Note C - Promissory Notes Payable and Related Party Transactions

During fiscal year 2001, Challenger Center received two loans from board members in exchange for promissory notes, in the amounts of \$100,000 and \$50,000, which matured in March and May 2005, respectively. These maturity dates were extended until March and May 2006, respectively. These notes bear interest at the prime rate of interest as published in The Wall Street Journal on the first day of each quarter, which was 5.75% and 4.00% at June 30, 2005 and 2004, respectively. Challenger Center pays the accrued interest quarterly.

During fiscal year 2002, Challenger Center received a five-year promissory note payable for the financing of one-half of the EdVenture Lab prototype from the fabricator vendor. The payment terms are annual installments of \$15,000, plus simple interest at a rate of 6.0% per year on the outstanding balance. As of June 30, 2005 and 2004 the total outstanding balances of the note were \$0 and \$15,675, respectively. The 2004 balance is included in the Statements of Financial Position as notes payable.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note D - Pledges Receivable

Pledges receivable primarily consists of the Challenger Center's Major Gifts and is comprised as follows at June 30:

	2005	2004
Pledges receivable within one year	\$ 532,954	\$ 304,225
Pledges receivable from one to five years	156,700	743,155
Less: Allowance for doubtful accounts and imputed interest	(18,304)	(61,411)
	\$ 671,350	\$ 985,969

The above pledge receivables were discounted at a rate of 7% and 6% for 2005 and 2004, respectively.

Note E - Property, Land and Equipment

Property, land and equipment are recorded at cost and consist of the following at June 30:

	2005	2004
Building and leasehold improvements	\$ 92,126	\$ 2,870,969
Challenger Learning Center of Greater Washington (CLCGW)	425,305	425,305
Exhibits	383,692	383,692
Equipment	635,446	655,051
Furniture & fixtures	259,332	263,277
Total property and equipment	1,795,901	4,598,294
Less accumulated depreciation and amortization	(1,248,251)	(1,625,986)
Net property and equipment	547,650	2,972,308
Land	-	1,010,000
	\$ 547,650	\$ 3,982,308

As of June 30, 2005 fixed assets include capitalized costs of \$150,000 relating to the fabrication and installation of a prototype EdVenture Lab at Challenger Center's headquarters facility. Of the total costs, \$75,000 was donated by the vendor and, therefore, recognized during 2002 as in-kind support. The remaining \$75,000 was financed in the form of a five-year promissory note payable as describe in Note C.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note F - Science, Space, and Technology Education Trust Fund

In accordance with Public Law 100-404 (1989), National Aeronautics and Space Administration (NASA) transferred \$15,000,000 of appropriated funds to establish the "Science, Space, and Technology Education Trust Fund" ("the trust fund"). The trust fund as stipulated by Public Law 100-404 named Challenger Center as a beneficiary of the trust for a period of ten years. In September 1994, Congress passed Public Law 103-327, which, in part, amended the terms of the trust fund, allowing the trust fund to exist in perpetuity.

The trust fund invests in United States Treasury special issue securities. Challenger Center receives the lesser of actual interest earned or \$1,000,000 per year from the trust fund provided that Challenger Center generates dollar-for-dollar matching of funds from non-federal sources and these funds have been used to further science, space and technology education. The trust fund disburses the interest earnings to Challenger Center each calendar quarter in the amount of \$250,000, which is reflected as unrestricted income. Challenger Center received disbursements totaling \$1,000,000 from the trust fund, for each of the years ended June 30, 2005 and 2004.

Residual interest income generated from the bonds is used by the trust to purchase additional bonds to insure a par value of \$15,000,000 at the date of maturity, which maintains the corpus in accordance with Public Law 100-404.

At June 30, 2005 and 2004, Challenger Center recognized in its permanently restricted net assets a beneficial interest in the trust fund in the amount of \$15,873,942 and \$15,900,136, respectively, which represents the amortized cost of the investments held by the trust fund. The amortized cost approximates the present value of all guaranteed future disbursements from the trust fund. At June 30, 2005 and 2004, these investments consist of U.S. Treasury bonds (interest at 8.875%) with par value of \$13,318,000 and \$13,195,000, respectively, which mature on February 15, 2019. The change in fair value, which is reflected through the change in permanently restricted net assets, represents the net activity during the year for purchases of additional bonds by the trust and the amortization of the bond premiums.

In accordance with the provisions of the trust fund, as of June 30, 2005, Challenger Center has generated total matching funds of \$62,710,680 and has received disbursements totaling \$16,750,000, since inception.

Note G - Concentrations - Sale of Learning Centers

For the years ended June 30, 2005 and 2004, Challenger Center generated 22% and 43% of its total annual revenues, respectively, from the sale of Learning Centers. Challenger Center contracts with one vendor for the fabrication of the Learning Center Simulators. As of June 30, 2005 and 2004, respectively, Challenger Center owes approximately \$678,000 and \$928,000 to this vendor, which has been reflected in accounts payable and accrued expenses.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note H - Allocation of Joint Costs

Joint costs of direct mailings are allocated on the basis of the mailing's content, the reasons for distribution and the audience to whom it was addressed. During the fiscal years ended June 30, 2005 and 2004, Challenger Center incurred \$35,723 and \$50,467, respectively, in expenses to conduct its direct mail campaign. Of this, \$26,078 and \$25,234, respectively, was allocated to the public awareness program and the remainder, \$9,645 and \$25,233, respectively, to fundraising.

Note I - Employee Benefit Plan

Challenger Center maintains a defined contribution benefit plan, which meets the requirements of Section 403(b) of the Internal Revenue Code. The plan is open to all full-time employees upon their date of hire. The plan was revised on April 1, 2003. Effective April 1, 2003, employees may contribute up to the limits permitted under Section 415 of the Internal Revenue Code, currently \$14,000. Challenger Center matches 30% of employee contributions up to the first 6% of the employee's annual salary. Challenger Center's contributions to the employee accounts vest 100% when made. Challenger Center's contributions to the plan amounted to \$26,406 and \$30,409 for the years ended June 30, 2005 and 2004, respectively.

Note J - Commitments

In September 1998, Challenger Center entered into a five-year lease for office space in Kansas City, Missouri that expired on October 31, 2003. Challenger Center renewed the terms of the lease for an additional five-year term.

Challenger Center subleased office space to a tenant under a three-year lease beginning January 1, 2004, which expires December 31, 2006. Sublease income was approximately \$135,000 and \$40,000 for the years ended June 30, 2005 and 2004, respectively.

Additionally, Challenger Center leases photocopying and postage equipment under non-cancelable operating leases.

Challenger Center for Space Science Education

Notes to Financial Statements (Continued)

Note J - Commitments (Continued)

Future minimum rental payments under non-cancelable leases, having initial or remaining terms of more than one year at June 30, 2005, are as follows:

<u>Fiscal Year</u>	<u>Lease Payments</u>	<u>Sub-lease Rental Payments</u>	<u>Net</u>
2006	\$ 812,489	\$ 271,940	\$ 540,549
2007	823,129	138,774	684,355
2008	837,070	-	837,070
2009	806,316	-	806,316
2010	798,427	-	798,427
Thereafter	<u>3,352,396</u>	<u>-</u>	<u>3,352,396</u>
	<u>\$ 7,429,827</u>	<u>\$ 410,714</u>	<u>\$ 7,019,113</u>

Rent expense under operating leases for fiscal years ended June 30, 2005 and 2004 was \$795,601 and \$92,572, respectively.

On July 14, 2004, Challenger Center sold the building at 1250 North Pitt Street to Apollo 18, LLC as part of a sale-leaseback transaction. The sale price of the building was \$5,616,000 resulting in a gain of \$2,088,901, which is deferred over the ten-year life of the new lease. Challenger Center will lease the entire building for \$60,188 per month for ten years, subject to escalation clauses.

Note K - Ongoing Operations (Unaudited)

During the year ended June 30, 2005, Challenger Center increased its focus on streamlining operations and positioning the organization to meet the demands of the future. With operations on more stable footing, Challenger Center is preparing for the future through the revitalization of existing product lines and broadening of the target market. With the renewed focus on providing a more state of the art experience for both existing and future customers, Challenger Center is well poised to increase financial stability and for sustainable growth in the future.