



**FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012
TOGETHER WITH
INDEPENDENT AUDITOR'S REPORT**

EARTHWATCH INSTITUTE, INC.

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SEPTEMBER 30, 2013 AND 2012**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Earthwatch Institute, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Earthwatch Institute, Inc. (a Massachusetts corporation, not for profit) which comprise the statements of financial position as of September 30, 2013 and 2012, and the related statements of activities, changes in net assets, cash flows and functional expenses 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.

Auditor's Responsibility

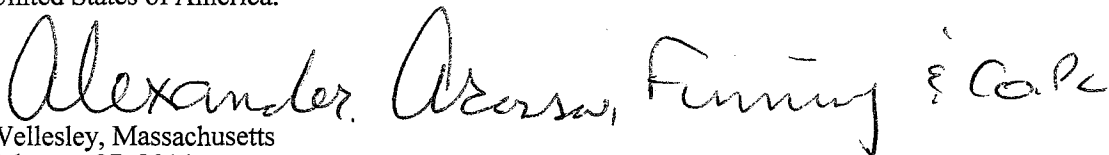
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about 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 Earthwatch Institute, Inc. as of September 30, 2013 and 2012, 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.


Wellesley, Massachusetts
February 27, 2014

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2013 AND 2012

<u>ASSETS</u>	2013				2012			
	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
CURRENT ASSETS:								
Cash and cash equivalents	\$ 290,870	\$ 362,889	\$ -	\$ 653,759	\$ -	\$ 224,443	\$ -	\$ 224,443
Short-term investments	-	843,299	-	843,299	-	715,165	-	715,165
Current portion of grants and pledges receivable	145,665	1,673,080	-	1,818,745	88,000	1,356,639	-	1,444,639
Prepaid field grant expense, net	83,207	-	-	83,207	32,858	-	-	32,858
Prepaid expenses	59,786	-	-	59,786	61,590	-	-	61,590
Due from affiliates, net	119,546	-	-	119,546	120,207	-	-	120,207
Due (to) from	87,027	(47,679)	(39,348)	-	(158,565)	200,864	(42,299)	-
Total current assets	<u>786,101</u>	<u>2,831,589</u>	<u>(39,348)</u>	<u>3,578,342</u>	<u>144,090</u>	<u>2,497,111</u>	<u>(42,299)</u>	<u>2,598,902</u>
INVESTMENTS	-	293,201	1,468,501	1,761,702	-	157,442	1,306,736	1,464,178
GRANTS AND PLEDGES RECEIVABLE, net of current portion and discount	-	584,204	150,000	734,204	-	916,431	298,025	1,214,456
PROPERTY AND EQUIPMENT, net	65,390	-	-	65,390	68,658	-	-	68,658
OTHER ASSETS:								
Interest in insurance policy contracts	433,108	-	-	433,108	423,759	-	-	423,759
Lease deposit	25,000	-	-	25,000	25,000	-	-	25,000
Intangible assets	66,895	-	-	66,895	66,895	-	-	66,895
Total assets	<u>\$ 1,376,494</u>	<u>\$ 3,708,994</u>	<u>\$ 1,579,153</u>	<u>\$ 6,664,641</u>	<u>\$ 728,402</u>	<u>\$ 3,570,984</u>	<u>\$ 1,562,462</u>	<u>\$ 5,861,848</u>
<u>LIABILITIES AND NET ASSETS</u>								
CURRENT LIABILITIES:								
Accounts payable and accrued expenses	\$ 666,658	\$ -	\$ -	\$ 666,658	\$ 576,945	\$ -	\$ -	\$ 576,945
Deferred expedition income	976,795	-	-	976,795	682,620	-	-	682,620
Total current liabilities	<u>1,643,453</u>	<u>-</u>	<u>-</u>	<u>1,643,453</u>	<u>1,259,565</u>	<u>-</u>	<u>-</u>	<u>1,259,565</u>
ACCRUED RENT	<u>10,152</u>	<u>-</u>	<u>-</u>	<u>10,152</u>	<u>40,286</u>	<u>-</u>	<u>-</u>	<u>40,286</u>
Total liabilities	<u>1,653,605</u>	<u>-</u>	<u>-</u>	<u>1,653,605</u>	<u>1,299,851</u>	<u>-</u>	<u>-</u>	<u>1,299,851</u>
NET ASSETS:								
Unrestricted:								
Property and equipment and intangibles	132,285	-	-	132,285	135,553	-	-	135,553
Operating	(409,396)	-	-	(409,396)	(707,002)	-	-	(707,002)
Total unrestricted	<u>(277,111)</u>	<u>-</u>	<u>-</u>	<u>(277,111)</u>	<u>(571,449)</u>	<u>-</u>	<u>-</u>	<u>(571,449)</u>
Temporarily restricted	-	3,708,994	-	3,708,994	-	3,570,984	-	3,570,984
Permanently restricted	-	-	1,579,153	1,579,153	-	-	1,562,462	1,562,462
Total net assets	<u>(277,111)</u>	<u>3,708,994</u>	<u>1,579,153</u>	<u>5,011,036</u>	<u>(571,449)</u>	<u>3,570,984</u>	<u>1,562,462</u>	<u>4,561,997</u>
Total liabilities and net assets	<u>\$ 1,376,494</u>	<u>\$ 3,708,994</u>	<u>\$ 1,579,153</u>	<u>\$ 6,664,641</u>	<u>\$ 728,402</u>	<u>\$ 3,570,984</u>	<u>\$ 1,562,462</u>	<u>\$ 5,861,848</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013				2012			
	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
OPERATING REVENUE AND SUPPORT:								
Gifts and grants	\$ 948,386	\$ 4,387,880	\$ -	\$ 5,336,266	\$ 670,536	\$ 3,917,122	\$ -	\$ 4,587,658
Contributions from domestic volunteers	3,136,150	-	-	3,136,150	3,191,367	-	-	3,191,367
Contributions from overseas volunteers	253,182	-	-	253,182	605,365	-	-	605,365
Donated advertising	95,751	-	-	95,751	-	-	-	-
Investment return designated for operations	47,679	-	-	47,679	-	-	-	-
Investment income	29,097	-	-	29,097	19,952	-	-	19,952
Other	4,804	-	-	4,804	6,751	-	-	6,751
Net assets released from purpose restrictions	4,134,950	(4,134,950)	-	-	5,245,243	(5,245,243)	-	-
Net assets released from time restrictions	203,000	(203,000)	-	-	123,500	(123,500)	-	-
Total operating revenue and support	8,852,999	49,930	-	8,902,929	9,862,714	(1,451,621)	-	8,411,093
OPERATING EXPENSES:								
Program	7,114,082	-	-	7,114,082	7,371,358	-	-	7,371,358
General and Administration	1,147,451	-	-	1,147,451	1,325,872	-	-	1,325,872
Fundraising	383,670	-	-	383,670	402,230	-	-	402,230
Total operating expenses	8,645,203	-	-	8,645,203	9,099,460	-	-	9,099,460
Changes in net assets from operations	207,796	49,930	-	257,726	763,254	(1,451,621)	-	(688,367)
NON-OPERATING REVENUES (EXPENSES):								
Investment return, net	86,542	135,759	11,765	234,066	72,533	157,442	21,086	251,061
Endowment contributions	-	-	4,926	4,926	-	-	-	-
Cancellation of grant	-	-	-	-	-	(127,769)	-	(127,769)
Investment return designated for operations	-	(47,679)	-	(47,679)	-	-	-	-
Total non-operating revenues (expenses)	86,542	88,080	16,691	191,313	72,533	29,673	21,086	123,292
Changes in net assets	\$ 294,338	\$ 138,010	\$ 16,691	\$ 449,039	\$ 835,787	\$ (1,421,948)	\$ 21,086	\$ (565,075)

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

**STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
NET ASSETS , September 30, 2011	\$ (1,407,236)	\$ 4,992,932	\$ 1,541,376	\$ 5,127,072
Changes in net assets	<u>835,787</u>	<u>(1,421,948)</u>	<u>21,086</u>	<u>(565,075)</u>
NET ASSETS , September 30, 2012	(571,449)	3,570,984	1,562,462	4,561,997
Changes in net assets	<u>294,338</u>	<u>138,010</u>	<u>16,691</u>	<u>449,039</u>
NET ASSETS , September 30, 2013	<u>\$ (277,111)</u>	<u>\$ 3,708,994</u>	<u>\$ 1,579,153</u>	<u>\$ 5,011,036</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets from operations	\$ 257,726	\$ (688,367)
Adjustments to reconcile changes in net assets from operations to net cash provided by (used in) operating activities:		
Depreciation	35,830	59,539
Change in discount on grants and pledges receivable - operating	(4,822)	(11,805)
Donated stock	(63,930)	(113,678)
Investment return designated for operations	(47,679)	-
Cancellation of grant	-	(127,769)
Changes in operating assets and liabilities:		
Grants and pledges receivable	(32,131)	423,727
Prepaid field grant expense, net	(50,349)	11,818
Prepaid expenses	1,804	43,248
Due from affiliates, net	661	59,481
Accounts payable and accrued expenses	44,804	27,206
Deferred expedition income	294,175	(275,891)
Accrued rent	(17,787)	11,373
	<u>418,302</u>	<u>(581,118)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	-	(16,895)
Grants and pledges receivable - permanently restricted	148,025	197,049
Change in interest in insurance policy contracts	(9,349)	(4,644)
Purchase of investments	(882,417)	(1,189,568)
Proceeds from sale of investments	754,755	1,079,966
	<u>11,014</u>	<u>65,908</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	429,316	(515,210)
CASH AND CASH EQUIVALENTS, beginning of year	<u>224,443</u>	<u>739,653</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 653,759</u>	<u>\$ 224,443</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Property and equipment financed through accounts payable	<u>\$ 32,562</u>	<u>\$ -</u>
Change in discount on grants and pledges receivable - permanently restricted	<u>\$ 4,926</u>	<u>\$ -</u>
Cash paid for interest	<u>\$ -</u>	<u>\$ 10,237</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012

	2013				2012			
	<u>PROGRAM</u>	<u>GENERAL AND ADMINIS- TRATION</u>	<u>FUND- RAISING</u>	<u>TOTAL EXPENSES</u>	<u>PROGRAM</u>	<u>GENERAL AND ADMINIS- TRATION</u>	<u>FUND- RAISING</u>	<u>TOTAL EXPENSES</u>
SALARY AND RELATED:								
Salaries	\$ 2,404,149	\$ 611,948	\$ 159,447	\$ 3,175,544	\$ 2,185,975	\$ 707,364	\$ 171,599	\$ 3,064,938
Payroll taxes	282,366	53,977	14,785	351,128	210,504	60,127	65,632	336,263
Fringe benefits	138,766	71,945	12,019	222,730	113,111	70,995	46,376	230,482
Total salary and related	<u>2,825,281</u>	<u>737,870</u>	<u>186,251</u>	<u>3,749,402</u>	<u>2,509,590</u>	<u>838,486</u>	<u>283,607</u>	<u>3,631,683</u>
FIELD GRANTS	<u>2,330,501</u>	<u>-</u>	<u>-</u>	<u>2,330,501</u>	<u>2,689,891</u>	<u>-</u>	<u>-</u>	<u>2,689,891</u>
OTHER:								
Program expenses	481,578	12,722	37	494,337	500,594	12,172	468	513,234
Travel, staff development, seminars and conferences	314,389	80,488	5,021	399,898	199,264	40,176	22,519	261,959
Consultants and temporary help	199,780	49,707	43,500	292,987	633,404	140,443	16,571	790,418
Rent	168,087	58,787	37,682	264,556	207,902	54,494	20,364	282,760
Advertising	250,416	6,345	-	256,761	18,603	2,715	-	21,318
Printing and postage	96,853	1,961	82,219	181,033	161,745	23,584	20,650	205,979
Insurance	96,018	20,532	4,332	120,882	121,750	10,530	3,935	136,215
Bank fees and merchant fees	96,392	20,913	-	117,305	71,439	32,472	-	103,911
Legal and accounting	50,959	62,213	-	113,172	9,894	71,719	-	81,613
Miscellaneous	58,097	16,282	2,906	77,285	19,070	-	-	19,070
Meals and lodging	31,162	41,020	5,098	77,280	105,578	36,248	22,057	163,883
Telephone	41,018	14,498	7,060	62,576	52,886	13,599	5,082	71,567
Depreciation	22,705	7,998	5,127	35,830	42,685	12,269	4,585	59,539
Facilities	19,435	6,793	4,354	30,582	12,874	3,701	1,383	17,958
Program equipment grants	16,290	-	-	16,290	10,314	-	-	10,314
Information technology	14,756	8,459	-	23,215	-	21,372	-	21,372
Dues and subscriptions	-	837	-	837	3,875	566	1,009	5,450
Building repairs and maintenance	292	-	66	358	-	1,089	-	1,089
Freight	73	26	17	116	-	-	-	-
Interest	-	-	-	-	-	10,237	-	10,237
Total other	<u>1,958,300</u>	<u>409,581</u>	<u>197,419</u>	<u>2,565,300</u>	<u>2,171,877</u>	<u>487,386</u>	<u>118,623</u>	<u>2,777,886</u>
Total expenses	<u>\$ 7,114,082</u>	<u>\$ 1,147,451</u>	<u>\$ 383,670</u>	<u>\$ 8,645,203</u>	<u>\$ 7,371,358</u>	<u>\$ 1,325,872</u>	<u>\$ 402,230</u>	<u>\$ 9,099,460</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(1) OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES

OPERATIONS AND NONPROFIT STATUS

Earthwatch Institute, Inc. (Earthwatch) is dedicated to building a healthy and sustainable planet. Earthwatch grants monetary and volunteer support to scientific field research and multi-cultural awareness efforts in our most threatened human and wildlife communities each year. Findings are used to teach local residents how to improve their lives and livelihoods through sustainable business and development, inform state and local policy makers and educate our international volunteer force on their impact and responsibilities as global citizens. Innovative educational programs for teachers and students improve scientific literacy and environmental awareness in our next generation of leaders, while strategic academic, corporate and government partnerships engage all sectors in long-lasting protection of our natural and cultural resources.

Earthwatch is exempt from Federal income taxes as an organization (not a private foundation) formed for charitable purposes under Section 501(c)(3) of the Internal Revenue Code (IRC). Earthwatch is also exempt from state income taxes. Donors may deduct contributions made to Earthwatch within IRC requirements.

SIGNIFICANT ACCOUNTING POLICIES

Earthwatch prepares its financial statements in accordance with generally accepted accounting standards and principles established by the Financial Accounting Standards Board (FASB). References to U.S. GAAP in these footnotes are to the FASB Accounting Standards Codification.

Revenue Recognition

Earthwatch recognizes contributions from domestic and overseas research volunteers at the end of the month in which the volunteers participate in the research expeditions. Gifts of cash and other assets are recognized as temporarily restricted support if they are received or unconditionally pledged with donor stipulations that limit the use of the donated assets. When a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported on the statements of activities as net assets released from restrictions.

Grants are recognized over the period covered by the grant as services are provided and costs are incurred. Unrestricted contributions are recognized when unconditionally pledged in writing or received. Donor restricted endowment contributions are recorded as permanently restricted revenue and net assets if they are received and committed with donor stipulations that the net assets be held in perpetuity. All other revenue is recognized as earned.

Estimates

The preparation of financial statements in accordance with U.S. GAAP 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

(Continued)

(1) OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Assets

Earthwatch's net assets include the following:

• **Unrestricted:**

Property and equipment and intangibles represent the net book value of Earthwatch's property and equipment and intangible assets, net of related debts.

Operating represents the portion of net assets that is available for operations and does not have any donor imposed restrictions.

- **Temporarily restricted** represents grants and contributions whose uses have been limited by donors to a specific time period or purpose, including for underwriting field research for teachers and students and special projects. Earthwatch utilized \$200,864 of temporarily restricted net assets as of September 30, 2012, for operating cash flow. This amount was reflected as due (to) from in the accompanying statement of financial position as of September 30, 2012. These amounts were replenished during fiscal year 2013. Temporarily restricted net assets also include appreciation on unspent earnings on permanently restricted endowment.

Temporarily restricted net assets consist of the following at September 30:

	<u>2013</u>	<u>2012</u>
Purpose restricted	\$3,393,472	\$3,140,542
Time restricted	70,000	273,000
Appreciation and unspent earnings on permanently restricted endowment	<u>245,522</u>	<u>157,442</u>
	<u>\$3,708,994</u>	<u>\$3,570,984</u>

- **Permanently restricted** represents grants and contributions that have been restricted by donors to be maintained by Earthwatch in perpetuity (endowment funds). The investment income from these funds is to be used to provide educational grants and for other operating purposes, in accordance with Earthwatch's spending policy (see page 10).

Expense Allocations

Management allocates expenses related directly to a program to that program while other expenses are allocated based upon management's estimate of the percentage attributable to each program.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

(Continued)

(1) OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, Equipment and Depreciation

Property and equipment are recorded at cost, if purchased, or at fair value at time of receipt, if donated. Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

Software, equipment and other	3 - 7 years
Leasehold improvements	Lessor of 5 years or the life of lease

Property and equipment consist of the following at September 30:

	<u>2013</u>	<u>2012</u>
Software	\$1,052,322	\$1,052,322
Office equipment	290,024	290,024
Data processing equipment	394,678	394,678
Other	99,157	99,157
Leasehold improvements	<u>64,486</u>	<u>31,924</u>
	1,900,667	1,868,105
Less – accumulated depreciation	<u>1,835,277</u>	<u>1,799,447</u>
	<u>\$ 65,390</u>	<u>\$ 68,658</u>

Cash and Cash Equivalents

Earthwatch considers all highly liquid investments purchased with an initial maturity of three months or less to be cash and cash equivalents, except for money market accounts maintained as part of the investment portfolio (see Note 3). Cash and cash equivalents consist of checking and money market accounts in the accompanying financial statements.

Allowance of Grants and Pledges Receivable

Collections of the Earthwatch Europe's grants and pledges receivable are based upon management's projections of the timing of receipt of grant funds.

Prepaid Field Grants Expense

Prepaid field grants expense represent advances to researchers who generally field expeditions within two months of receipt of the advance. Accrued field grants (\$19,175 and \$20,696 at September 30, 2013 and 2012, respectively) represent amounts due to researchers upon completion of a project and their filing specific reports. These amounts, which are netted with prepaid field grants, are forfeited by the researcher if the reports are not submitted to Earthwatch by the date that is outlined in the contract. Field grant expenses are recognized when the expeditions are fielded.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

(Continued)

(1) **OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES**
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Advertising Costs

Earthwatch expenses advertising costs as they are incurred, or at the time of donation.

Donated advertising is valued at the estimated value assigned to them by the donating organization or by management.

Bequests

Earthwatch may be named as a beneficiary in wills and trusts and periodically may receive distributions. Earthwatch reflects bequests and trust distributions as non-operating revenue when received or when amounts to be received are known.

Deferred Expedition Income

Deferred expedition income includes volunteer payments for future research expeditions. Under certain circumstances, these payments may be refunded, less a handling fee, if the volunteer does not participate in an expedition within prescribed time frames. Earthwatch recognizes these contributions as revenue at the earlier of either the expedition departure date or a three-year expiration date.

Fair Value Measurements

Earthwatch follows the *Fair Value Measurements and Disclosures* standards, which establishes a fair value hierarchy that prioritizes the inputs and assumptions used to measure fair value. Earthwatch values its qualifying assets and liabilities using Level I inputs. Level I inputs reflect unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date. A qualifying asset or liability's level within the framework is based upon the lowest level of any input that is significant to the fair value measurement.

Investment Return Allocations

Earthwatch follows the Massachusetts adopted version of the Uniform Prudent Management Institutional Funds Act (UPMIFA). Subject to the intent of a donor, Earthwatch may appropriate for expenditure or accumulate so much of an endowment fund as Earthwatch determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. The assets in an endowment fund are donor-restricted assets until appropriated for expenditure by Earthwatch. Earthwatch has adopted investment and spending policies for endowment assets that aim to safeguard the purchasing power of the endowment principal, generate an ongoing revenue source, and provide for growth of the investment principal in accordance with UPMIFA.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

(Continued)

(1) **OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES**
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Return Allocations (Continued)

The Board of Directors of Earthwatch adopted a policy allowing for the use of a portion of total investment return on permanently restricted investments for operations each year. Annually, Earthwatch may appropriate for operations up to 5% of the average market values of its permanently restricted investment portfolio over the previous three years, measured at the end of the third quarter of the fiscal year. Under Earthwatch's policy, in no event shall such distribution reduce the value of the permanently restricted endowment portfolio below the historical dollar value at the time of the distribution. During fiscal year 2013, \$47,679 was appropriated for operations (see Note 4). There were no appropriations for the year ended September 30, 2012.

Investment income and gains and losses on endowment funds are reflected as non-operating revenues (expenses) in the accompanying statements of activities.

Accounting for Uncertainty in Income Taxes

Earthwatch follows the *Accounting for Uncertainty in Income Taxes* standard, which requires Earthwatch to report uncertain tax positions, related interest and penalties, and to adjust its assets and liabilities related to unrecognized tax benefits and accrued interest and penalties accordingly. As of September 30, 2013 and 2012, Earthwatch determined that there are no material unrecognized tax benefits to report. No income tax provision has been included in the accompanying financial statements. Earthwatch is subject to audit by tax authorities. Earthwatch believes that they have appropriate support for the positions taken on their information returns.

Earthwatch files information returns in the Federal and Massachusetts state jurisdictions. These returns are generally subject to examination by tax authorities for three years after the filing date.

Subsequent Events

Subsequent events have been evaluated through February 27, 2014, which is the date the financial statements were available to be issued. There were no events that met the criteria for recognition or disclosure in the financial statements.

(2) **RELATED PARTY TRANSACTIONS**

Earthwatch has charitable affiliates internationally to extend its scientific and education programs abroad. Earthwatch Australia was established in Sydney, Australia in 1980. Conservation Education and Research Trust (a company limited by guarantee) (doing business as Earthwatch Institute Europe), operating from Oxford, England, was established in 1984. A memorandum of understanding dated January, 1994, was implemented to create an affiliate in Tokyo, Japan (Earthwatch Japan).

Earthwatch does not control these affiliates; therefore, their results of operations are not included in the accompanying financial statements. These affiliates share contributions from volunteers with and derive staff support and subsidies from Earthwatch. Earthwatch maintains one member on each of the affiliate's Boards of Directors and one member from each affiliate serves as an ex-officio member of Earthwatch's Board.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012

(Continued)

(2) **RELATED PARTY TRANSACTIONS** (Continued)

The following are the amounts due from affiliates as of September 30:

	<u>2013</u>	<u>2012</u>
Amounts due from, net:		
Earthwatch Australia	\$ 45,451	\$ 45,373
Earthwatch Europe	35,509	66,900
Earthwatch Japan	<u>38,586</u>	<u>7,934</u>
	<u>\$119,546</u>	<u>\$120,207</u>

The following revenue is derived from affiliates and is reflected as contributions from overseas volunteers in the accompanying statements of activities for the years ended September 30:

	<u>2013</u>	<u>2012</u>
Revenue derived from:		
Earthwatch Australia	\$140,952	\$135,864
Earthwatch Europe	62,305	443,334
Earthwatch Japan	<u>49,925</u>	<u>26,167</u>
	<u>\$253,182</u>	<u>\$605,365</u>

During fiscal year 2007, Earthwatch received a grant of approximately \$10,166,000 from Earthwatch Europe, as part of a grant to Earthwatch Europe from HSBC Holdings PLC (HSBC). Earthwatch participated, as a sub-grantee, in the climate change field research project. Earthwatch carried out portions of the project in North, South and Central America over the past six years. Earthwatch received the entire \$10,166,000 as of September 30, 2012.

During fiscal years 2013 and 2012, Earthwatch received grants of approximately \$924,000 and \$1,261,000, respectively, from Earthwatch Europe, as part of a new grant to Earthwatch Europe from HSBC. Earthwatch is participating as a sub-grantee, in this global water quality research project. Earthwatch will be carrying out portions of the project in North and Latin America over five years. Earthwatch has received \$1,496,996 and \$524,701 as of September 30, 2013 and 2012, respectively. The balance of these grants at September 30, 2013 and 2012, is \$688,004 and \$736,299, respectively, and is included in grants and pledges receivable (see Note 9).

During fiscal years 2013 and 2012, Earthwatch also had other one-year grants with Earthwatch Europe with funding from HSBC. The funding totaled \$946,991 and \$201,018 for fiscal years 2013 and 2012, respectively.

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(Continued)

(2) RELATED PARTY TRANSACTIONS (Continued)

The balance of temporarily restricted net assets from these related party grants is as follows as of September 30:

	<u>2013</u>	<u>2012</u>
HSBC Water Project	\$ 926,856	\$ 985,408
Other HSBC Projects	421,328	73,203
HSBC Climate Project	<u>52,610</u>	<u>63,764</u>
	<u>\$1,400,794</u>	<u>\$1,122,375</u>

Additionally, during fiscal year 2013, Earthwatch Europe provided Earthwatch with a \$362,763 grant to supplement program expenses. This amount is included in gifts and grants in the accompanying fiscal year 2013 statement of activities.

On October 6, 2008, Earthwatch and Earthwatch Europe organized and incorporated Earthwatch International, Inc. (Earthwatch International) (a Delaware corporation, not for profit under IRC Section 501(c)(4)). Earthwatch International has no assets and had no activity as of and for the years ended September 30, 2013 and 2012. The Board of Directors of Earthwatch International consists of the Board members of each of the incorporators, with each incorporator having equal voting power. Earthwatch International's purpose is to provide internationally coordinated governance and administration for the benefit of organizations throughout the world that use Earthwatch trademarks and brand. Each party maintains its own independent governance and financial integrity. Certain costs, key executives and program and administrative staff serve both Earthwatch and Earthwatch Europe and costs are shared under a memorandum of agreement between the organizations.

Earthwatch participates in a Split Dollar and Collateral Assignment Agreement with Earthwatch's Founding Chairman and Board member (non-voting) who is the owner of the insurance policies. Earthwatch made annual premium payments for the period November 1998 through December, 2010, as required under the agreement, totaling \$480,035. These policies are subject to termination upon certain defined circumstances. In the event of the split dollar policy cancellation, Earthwatch will receive an amount equal to the cash surrender value of the policy or the amount of premiums paid to date, whichever is less. In the event of death, Earthwatch will receive the cumulative amount of premium payments from the proceeds of the death benefit. The cash surrender values of the insurance policy contracts at September 30, 2013 and 2012, were \$433,108 and \$423,759, respectively. These amounts are reflected as interest in insurance policy contracts in the accompanying statements of financial position.

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012
(Continued)

(3) INVESTMENTS

Investment income consists of interest and dividends. Interest income is recorded as earned and dividend income is recorded on the ex-dividend date. Realized gains and losses on investment transactions are recorded based on the average cost method. Unrealized gains and losses are based on market value changes. These investments are not insured and are subject to ongoing market fluctuations. All investments are valued using Level 1 inputs (see Note 1) and consist of the following at September 30:

	<u>2013</u>	<u>2012</u>
Money market	\$ 464,060	\$ 313,913
Fixed income:		
Intermediate term bond funds	448,650	520,809
Other bond funds	187,144	242,571
Equities:		
Mutual funds:		
Other funds	498,509	359,238
Large growth funds	422,603	332,860
Large blend funds	304,178	180,661
Exchange traded funds	<u>279,857</u>	<u>229,291</u>
	<u>\$2,605,001</u>	<u>\$2,179,343</u>

The following is a summary of the net investment return of the portfolio for the years ended September 30:

	<u>2013</u>	<u>2012</u>
Unrealized gains on investments	\$141,418	\$ 344,355
Investment income, net of fees of \$2,154 and \$9,092 for the years ended September 30, 2013 and 2012, respectively	48,919	26,645
Net realized gains (losses) on investments	<u>43,729</u>	<u>(119,939)</u>
Investment return, net	<u>\$234,066</u>	<u>\$ 251,061</u>

The investments have been allocated among the unrestricted, temporarily restricted and permanently restricted net asset classes in the accompanying financial statements according to the absence or presence of donor restrictions.

Investments are reported in the accompanying statements of financial position as current or long-term assets based on management's intent with respect to the use of investments (see Note 4).

To satisfy its long-term rate-of-return objectives, Earthwatch relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Investment Committee, advised by a third party investment advisor, is responsible for selecting the investment manager of Earthwatch's portfolio.

Investment gains of \$11,765 and \$21,086 for the years ended September 30, 2013 and 2012, respectively, at the request of a donor, are to remain in the endowment (see Note 4).

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(Continued)

(4) ENDOWMENT

Changes in endowment net assets by class are as follows:

	<u>Donor-Restricted</u>			<u>Total Endowment</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, September 30, 2011	\$(10,298)	\$ -	\$1,541,376	\$1,531,078
Investment return:				
Unrealized gains on investments	10,298	149,145	21,086	180,529
Investment income, net of fees	-	26,645	-	26,645
Net realized losses on investments	-	(18,348)	-	(18,348)
Total investment return	<u>10,298</u>	<u>157,442</u>	<u>21,086</u>	<u>188,826</u>
Endowment net assets, September 30, 2012	<u>-</u>	<u>157,442</u>	<u>1,562,462</u>	<u>1,719,904</u>
Investment return:				
Unrealized gains on investments	-	85,547	11,765	97,312
Investment income, net of fees	-	48,919	-	48,919
Net realized gains on investments	-	1,293	-	1,293
Total investment return	<u>-</u>	<u>135,759</u>	<u>11,765</u>	<u>147,524</u>
Contributions	<u>-</u>	<u>-</u>	<u>4,926</u>	<u>4,926</u>
Investment return designated for operations	<u>-</u>	<u>(47,679)</u>	<u>-</u>	<u>(47,679)</u>
Endowment net assets, September 30, 2013	<u>\$ -</u>	<u>\$245,522</u>	<u>\$1,579,153</u>	<u>\$1,824,675</u>

(5) NOTE PAYABLE TO A BANK

Earthwatch has available up to \$500,000 under a line of credit agreement with a bank. Borrowings under the agreement are due on demand and interest is payable monthly at the bank's base lending rate (3.25% at September 30, 2013 and 2012), plus 1%. The line of credit is secured by substantially all business assets of Earthwatch. No amount was outstanding under this agreement at September 30, 2013 and 2012.

Earthwatch must comply with certain covenants, including maintaining certain financial ratios, as specified in the agreement. Earthwatch must, at all times, hold marketable securities, including corporate bonds, with an aggregate market value of no less than \$500,000. This agreement expires on September 30, 2014. Earthwatch was either in compliance with the covenants or obtained waivers as of September 30, 2013 and 2012.

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(Continued)

(6) OPERATING LEASES

On January 22, 2010, Earthwatch entered into a five-year lease agreement for office space in Allston, Massachusetts, commencing on May 1, 2010. This lease expires in May, 2015, and allows for a five-year renewal option. Earthwatch is responsible for its proportionate share of any increase in operating costs and real estate taxes over a base year and must maintain specified insurance coverage. In August, 2013, this lease was amended to reduce the square footage and proportionate share of operating costs. Earthwatch is recognizing rent expense on a straight-line basis over the term of the lease in accordance with the *Accounting for Leases* standard under U.S. GAAP. For the years ended September 30, 2013 and 2012, Earthwatch recognized rent expense of \$263,365 and \$264,439, respectively. As of September 30, 2013 and 2012, accrued rent was \$35,591 and \$53,378, respectively, of which \$25,439 and \$13,092, respectively, is current and is included in accounts payable and accrued expenses in the accompanying statements of financial position.

Facility rent expense for the years ended September 30, 2013 and 2012, was \$264,556 and \$282,760, respectively, which includes tenant-at-will rent expense of approximately \$1,000 and \$18,000, respectively.

Earthwatch had a vehicle operating lease for staff at a regional climate center that ended in April, 2012. Rent expense under this lease was \$2,408 for the year ended September 30, 2012.

Future minimum cash lease payments under non-cancelable operating leases are as follows:

<u>Fiscal Year</u>	<u>Facilities</u>
2014	\$173,448
2015	\$101,178

(7) INTANGIBLE ASSETS

Intangible assets of \$66,895 as of September 30, 2013 and 2012, consist of costs incurred by Earthwatch to register its trademarks in foreign countries. These intangible assets are not amortized; rather, they are tested for impairment on an annual basis to determine if the intangible assets are being carried on the statement of financial position at or above their implied value. An impairment exists when the implied fair value of the intangible assets is less than the corresponding carrying value of the intangible assets on the statement of financial position. Any impairment is recognized as a loss in the year the asset is determined to be impaired. There was no impairment loss at September 30, 2013 and 2012.

(8) EMPLOYMENT BENEFIT PLAN

Earthwatch maintains a qualified salary reduction plan (an IRC Section 401(k) plan), whereby employees who are 21 years of age and have accumulated 500 hours of service are eligible to make elective tax deferred contributions to the plan up to the maximum allowed by law. Earthwatch may contribute to the plan at the discretion of the Board of Directors and may match a portion of employee contributions. These matching contributions vest over a five-year period. Earthwatch made contributions of \$41,661 and \$69,566 during fiscal years 2013 and 2012, respectively.

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(Continued)

(9) GRANTS AND PLEDGES RECEIVABLE

Grants and pledges receivable consist of amounts committed to Earthwatch for both unrestricted and restricted purposes. These amounts are due as follows:

<u>Fiscal Year</u>	<u>2013</u>	<u>2012</u>
Less than one year	\$1,818,745	\$1,444,639
One to five years	<u>740,000</u>	<u>1,230,000</u>
	2,558,745	2,674,639
Less – discount	<u>5,796</u>	<u>15,544</u>
	2,552,949	2,659,095
Less - current portion	<u>1,818,745</u>	<u>1,444,639</u>
Long-term grants and pledges receivable, net	<u>\$ 734,204</u>	<u>\$1,214,456</u>

The pledges have been discounted using a 1.0% rate for fiscal years 2013 and 2012.

Earthwatch Europe's (see Note 2) grant receivable balances as of September 30, 2013 and 2012, were \$916,178 and \$736,438, respectively. These amounts represent approximately 36% and 28% of the total outstanding grants and pledges balance as of September 30, 2013 and 2012, respectively. Two other donors' balances represent approximately 47% and 59% of the outstanding pledge balance as of September 30, 2013 and 2012, respectively.

(10) CONCENTRATIONS AND CONTINGENCIES

Earthwatch maintains its cash balances in a Massachusetts bank and is insured within the limits of the Federal Deposit Insurance Corporation (FDIC). At certain times during the year, the cash balances exceeded the insured amount. Earthwatch has not experienced any losses in the accounts. Earthwatch's management believes Earthwatch is not exposed to any significant credit risk on cash and cash equivalents.

In the ordinary course of Earthwatch's business, Earthwatch is, from time-to-time, involved in disputes concerning certain individual's employment with Earthwatch. While these employees are seeking damages in connection with these disputes, Earthwatch denies any wrongdoing in these cases and is taking the appropriate legal steps in defense of these disputes. It is Earthwatch's opinion that any potential settlement would not be material to the accompanying financial statements.

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2013 AND 2012**

(Continued)

(11) CONTINUING OPERATIONS

Earthwatch incurred an unrestricted surplus from operations of \$207,796 and \$763,254 for the years ended September 30, 2013 and 2012, respectively. Temporarily restricted net assets from operations increased (decreased) by \$49,930 and \$(1,451,621) for the years ended September 30, 2013 and 2012, respectively. As of September 30, 2013, Earthwatch had a deficit unrestricted operating net assets balance of \$409,396 and unrestricted current liabilities exceeded unrestricted current assets by \$857,352.

Earthwatch has historically relied on cash flow from deferred expedition income and restricted funds to meet operating cash flow requirements.

During fiscal years 2013 and 2012, Earthwatch achieved an operating surplus, benefitting from actions taken by management in reducing operating costs and reducing its portfolio of projects. Additionally, during fiscal year 2013, Earthwatch Europe provided Earthwatch with a \$362,763 grant to supplement program expenses. Earthwatch also continued to benefit from cost reductions through the efficiencies of the shared costs with Earthwatch Europe (See Note 2). Earthwatch will continue to monitor costs and processes in fiscal year 2014 with the goal of achieving efficiencies and effectiveness in program delivery. In fiscal year 2014, management's main focus will be fundraising, continuing to improve program delivery efficiencies and developing the public program. In management's opinion, these actions will allow Earthwatch to generate sufficient cash flows to meet its program commitments for fiscal year 2014.