Scientific Learning®

Annual Report
December 31, 2019

www.scilearn.com

2019 Letter from the CEO

Your company, Scientific Learning, made considerable strides throughout 2019 in positioning itself for a brighter future. Key achievements include:

- Operational improvements to increase our Company's focus on K-12 and efficiency
- Product development releases that improve the customer experience and reduce our Flash exposure
- Balance sheet improvements to help the Company navigate a capital-constrained environment

In addition, we have some compelling K-12 booked sales momentum: in K-12, we had our best December since 2016. For overall Company booked sales, we had our best December since 2015.

For the fourth quarter of 2019, total booked sales were $2.9 million, as compared to $2.7 million in Q4 2018, an increase of 7%. K-12 booked sales were down 9%, as compared to an overall increase of 37% in our other product lines – International, Private Provider and Home – combined. Internationally, it was our largest December and Q4 ever.

For our balance sheet, in April 2019 we completed the restructuring of $6 million in subordinated debt with the principal due date extended from April 2020 to October 2022, interest rate reduced from 15 percent to 9 percent, and warrant coverage increased by 5 million shares, with a new warrant exercise price of $0.40 per share.

However, even with all of our company progress, we still face considerable challenges. We are highly capital constrained, and we would like to invest more and faster in our product to get ahead of what is happening in the marketplace. We continue to improve our net promoter scores, but there is still more room to grow. This is critical for a SaaS business like ours where a high percentage of our revenue is recurring, and we need to see very high renewal rates. On the booked sales side, our average order value has decreased, and we have a plan in place to improve this considerably, but it will not happen overnight.

I should add that, as I write this, the world is in the midst of the coronavirus pandemic. This is a completely unique circumstance, unprecedented, rapidly changing and life disrupting. Although I am somewhat fatigued from hearing these words, it does not make them any less true. This has impacted every dimension of our lives, which is impacting our business, including: schools are attempting a variety of different non-traditional learning approaches, our offices are closed while our team is working from home and not visiting customers in person, and the government is working to provide financial relief in a variety of ways.

For our Company, since our primary customer segment is K-12, and schools and district offices are staffed by public employees who are getting paid and expected to work, in theory, our customers are still open for business even though their places of employment (schools) are physically closed. On a practical basis, this means a variety of things from non-responsiveness to nearly business as usual from our perspective.

In fact, the first quarter of 2020 – from a booked sales perspective – is better than the first quarter of 2019. Renewals are doing well, which is why we are focused on our current customers, but new business is challenging. We are modifying our approach, for example, offering free software, specifically Reading Assistant Plus, to schools that need this tool (repositioned as an independent reading practice program) for their remote learning. This has resulted in a large number of pilots that we hope can be converted to paying customers later in the year.

In the end, we are reluctant to make too many statements about the ultimate impact of COVID-19 because this has been such an unpredictable time in our lives. We can say that we are doing all that we can to pivot and navigate this crisis successfully, including implementing a company-wide reduction in hours (to save payroll costs) and applying for government relief money.

Operational Improvements

In 2019, we undertook a broad range of operational improvements that are also changing the mindset of the Company to be more growth and results oriented. These actions include:

- Increasing our focus on our core K-12 business by exiting the Consumer segment
- Introducing re-factored products into the marketplace
- Streamlining the organizational structure to be more externally focused and save resources
- Restructuring our Service and Support departments into a Customer Success model that focuses on driving the customer relationship forward and ensuring successful renewals
- Revising our pricing structure to be more value-focused and customer-friendly
- Implementing a new "teaming" model for our K-12 sales force after a successful 2019 pilot

Product Development

2019 was a very strong year for product development. We segment our product development efforts into four categories and we have made significant progress in each area. Transitioning our products to HTML 5 (from Flash) in advance of the December 31, 2020 Flash end of life is critical. We now have converted nearly 70% of our program to HTML 5 based on customer usage.

Key highlights are as follows:

- Fast ForWord HTML 5 releases
  - Reading Readiness
  - Reading Progress Indicator
  - Improved reporting for Foundations I
  - Improved reporting for Foundations II
  - Improved reporting for Reading Readiness

- Customer Experience
  - Single sign-on integration (ClassLink)
  - Content acceleration
  - Data Anonymization for privacy concerns and compliance
  - Added ~100 new Reading Assistant Plus titles, giving us ~490
  - Improvements to Reading Assistant Plus user experience

- Maintenance and Technical Debt
  - End of life Reading Assistant Legacy
  - Ongoing Super User Tool Improvements
  - Various data privacy, security and encryption improvements
  - Reduced technical debt, e.g., new tech stack

- Progress against next phase for Fast ForWord ("Pathways")
  - Implementation of big data tools
  - Gather and research design requirements
  - New secondary literacy components (Elements I & II) in development

Other Developments

To increase our focus on K-12 and that market's ever-increasing requirements, we exited the Home/Consumer business in Q4 2019. Although this business had grown over the last 5-year period, we did not see a bright future in this segment.

Our margins were always challenged when operating this business, and despite many efforts to improve, this segment remained roughly breakeven. More recently, its growth had slowed, which made it even less attractive. Also, as we prioritized product development for K-12, the product became even less consumer friendly.

Financial Highlights and Details

As noted, total booked sales for Q4 2019 were $2.9 million, as compared to $2.7 million in Q4 2018, an increase of 7%.

Within this overall result, Q4 2019 K-12 booked subscription sales were up 8% over Q4 2018 and were up 2% for the full year. K-12 booked subscription sales now represent 86% of total booked license sales for 2019 as compared to 79% in 2018.

For full year ended December 31, 2019, total booked sales were $14.7 million, compared to $16.2 million in 2018, representing a decline of 9%. For K-12, the results were $11.3 million in 2019, as compared to $13.3 million for the same period in 2018. Our other product lines, including International, Private Provider and Home, posted booked sales of $3.4 million for the full year of 2019, compared to $2.9 million in the prior year, representing an increase of 15%.

As we examine the 2019 booked sales results more closely, there has been a decline in the number of large deals (transactions over $100,000). In 2018, the Company completed 20 large deals, while in 2019 the Company was only able to close 8 large deals. These large deals tend to be difficult to forecast and are usually more complicated to close. In fact, at quarter end we had 2 large transactions deep in the funnel that we were not able to close but have since closed in Q1 2020. This decline in large deals reflects a movement in K-12 decision-making from the district level to the school or building level.

Attached to this letter are our financial statements for the year ending December 31, 2019 as well as the disclosures according to the OTC disclosure guidelines.

We appreciate your support of Scientific Learning.

Jeff D. Thomas
Chief Executive Officer

Forward-looking statements

This letter and our attached financial report contain forward-looking statements. Forward-looking statements can be identified by words such as: "expect," "anticipate," "intend," "plan," "believe," "seek," "see," "will," "would," "estimate," "forecast," "target," "preliminary" and similar references to future periods. Such statements are subject to substantial risks and uncertainties. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual events or results may differ materially from those indicated in the forward-looking statements. Therefore, you should not rely on any of these forward-looking statements. Examples of forward-looking statements include, among others, statements we make regarding: anticipated future sales and financial results; availability of funding to purchase the Company's products and generally available to schools; the acceptance of new products and product changes in existing and new markets; the impact and timing of Flash's end of life; acceptance of subscription and other recurring offerings; expected sales growth and improved business results attributable to the release of new products and features; seasonality and sales cycles in Scientific Learning's markets; competition; the extent to which the Company's development, marketing, sales and implementation strategies are successful; personnel changes; future product plans; and the Company's ability to continue to demonstrate the efficacy of its products. Any forward-looking statement made by us in this letter and financial report are based only on information currently available to us and speaks only as of the date on which it is made. We undertake no obligation to publicly update any forward-looking statement that may be made from time to time, whether as a result of new information, future developments or otherwise.

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

To the Board of Directors
Scientific Learning Corporation
Oakland, California

We have audited the accompanying financial statements of Scientific Learning Corporation, a Delaware corporation (the "Company"), which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of operations, comprehensive loss, stockholders' deficit 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.

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 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.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company changed its method of accounting for leases in 2019 due to the adoption of Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842),* using the optional method of transition.

Emphasis of Matter

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has suffered recurring losses from operations that raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 1 to the financial statements, the Company's financial conditions and results of operations may be impacted by the outbreak of a novel coronavirus (COVID-19), which was declared a global pandemic by the World Health Organization in March 2020.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Scientific Learning Corporation as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ Armanino LLP
San Jose, California
April 14, 2020

SCIENTIFIC LEARNING CORPORATION
BALANCE SHEETS
(In thousands, except share and par value data)

	December 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 1,077	$ 3,389
Accounts receivable, net of allowance for doubtful accounts of $26 and $19 as of December 31, 2019 and 2018, respectively	1,824	1,837
Prepaid expenses and other current assets	599	560
Total current assets	3,500	5,786
Software development costs and equipment, net	2,821	2,775
Operating lease right-of-use assets	703	-
Other assets	135	336
Total assets	$ 7,159	$ 8,897
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable	$ 513	$ 273
Accrued liabilities	1,155	1,433
Operating and finance lease liabilities	462	27
Deferred revenue	9,058	9,923
Total current liabilities	11,188	11,656
Deferred revenue, net of current portion	2,156	2,415
Subordinated debt	5,327	6,000
Warrant liability	148	858
Operating and finance lease liabilities, net of current portion	430	23
Other liabilities	-	90
Total liabilities	19,249	21,042
Commitments and contingencies (see Note 14)		
Stockholders' deficit:		
Common stock, $0.001 par value, 60,000,000 shares authorized, 27,769,673 and 27,622,674 shares issued and outstanding as of December 31, 2019 and 2018, respectively, and additional paid-in capital	100,119	99,725
Accumulated deficit	(112,209)	(111,870)
Total stockholders' deficit	(12,090)	(12,145)
Total liabilities and stockholders' deficit	$ 7,159	$ 8,897

See accompanying notes to financial statements

SCIENTIFIC LEARNING CORPORATION
STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	Year Ended December 31, 2019	Year Ended December 31, 2018
Revenues:		
Subscription	$ 8,846	$ 8,931
License	1,988	2,462
Service and support	4,965	5,351
Total revenues	15,799	16,744
Cost of revenues:		
Cost of subscription	1,615	1,164
Cost of license	19	18
Cost of service and support	2,749	2,750
Total cost of revenues	4,383	3,932
Gross profit	11,416	12,812
Operating expenses:		
Sales and marketing	6,056	6,511
Research and development	3,174	2,839
General and administrative	3,210	3,795
Total operating expenses	12,440	13,145
Operating loss	(1,024)	(333)
Other income (expense):		
Interest and other expense, net	(852)	(933)
Change in the fair value of warrants	1,545	399
Total other income (expense)	693	(534)
Net loss before provision for income taxes	(331)	(867)
Provision for income taxes	8	6
Net loss	$ (339)	$ (873)
Net loss per share:		
Basic and diluted	$ (0.01)	$ (0.03)
Weighted average shares used in computing net loss per share:		
Basic and diluted weighted average shares outstanding	27,725	27,523

See accompanying notes to financial statements

SCIENTIFIC LEARNING CORPORATION
STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)

	Year Ended December 31,	
	2019	**2018**
Net loss	$ (339)	$ (873)
Other comprehensive income:		
Foreign currency translation adjustments, net of tax	-	11
Comprehensive net loss	$ (339)	$ (862)

See accompanying notes to financial statements

.

SCIENTIFIC LEARNING CORPORATION
STATEMENTS OF STOCKHOLDERS' DEFICIT
(In thousands, except share amounts)

	Common Stock and Additional Paid-In Capital								
	Shares		**Amount**		**Accumulated Deficit**		**Other Comprehensive Loss**		**Stockholders' Deficit**
Balance at December 31, 2017	**24,670,904**	**$**	**97,710**	**$**	**(111,015)**	**$**	**(11)**	**$**	**(13,316)**
Issuance of common stock upon private offering	2,944,000		1,840		-		-		1,840
Vesting of restricted stock units	7,770				-		-		-
Stock-based compensation expense	-		175		-		-		175
Currency translation adjustment	-		-		-		11		11
Deconsolidation of foreign subsidiary (see Note 1)	-		-		18		-		18
Net loss	-		-		(873)		-		(873)
Balance at December 31, 2018	**27,622,674**	**$**	**99,725**	**$**	**(111,870)**	**$**	**-**	**$**	**(12,145)**
Vesting of restricted stock units	216,641		-		-		-		-
Tax withholding related to vesting of restricted stock units	(69,642)		(22)		-		-		(22)
Stock-based compensation expense	-		416		-		-		416
Net loss	-		-		(339)		-		(339)
Balance at December 31, 2019	**27,769,673**	**$**	**100,119**	**$**	**(112,209)**	**$**	**-**	**$**	**(12,090)**

See accompanying notes to financial statements.

SCIENTIFIC LEARNING CORPORATION
STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31, 2019	Year Ended December 31, 2018
Operating Activities:		
Net loss	$ (339)	$ (873)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	1,128	775
Stock-based compensation expense	416	175
Amortization of debt discount and debt issuance costs	153	45
Change in fair value of warrant	(1,545)	(399)
Loss on disposition of foreign subsidiary	-	30
Changes in operating assets and liabilities:		
Accounts receivable	13	91
Prepaid expenses and other current assets	(39)	156
Operating lease right-of-use and other assets	(503)	185
Accounts payable	240	106
Accrued liabilities	64	131
Lease and other liabilities	792	(27)
Deferred revenue	(1,124)	(575)
Net cash used in operating activities	(744)	(180)
Investing Activities:		
Additions to capitalized software and purchases of equipment	(1,174)	(1,084)
Net cash used in investing activities	(1,174)	(1,084)
Financing Activities:		
Borrowings under line of credit	2,292	-
Repayment of borrowings under line of credit	(2,292)	-
Repayment of borrowings under subordinated debt	(333)	-
Payments under finance lease	(39)	(32)
Proceeds from issuance of common stock upon private offering	-	1,840
Net settlement of common stock	(22)	-
Net cash provided (used) by financing activities	(394)	1,808
Effect of exchange rate changes on cash and cash equivalents	-	(1)
(Decrease) increase in cash and cash equivalents	(2,312)	543
Cash and cash equivalents at beginning of period	3,389	2,846
Cash and cash equivalents at end of period	$ 1,077	$ 3,389
Supplemental disclosure of cash flow information		
Cash paid for income taxes	$ 13	$ 10
Cash paid for interest	$ 373	$ 845
Non-cash financing activities		
Fair value of common stock warrants issued in connection with subordinated debt restructure	$ 835	$ -

See accompanying notes to financial statements.

Notes to Financial Statements

1. Summary of Significant Accounting Policies

Description of Business

Scientific Learning Corporation (the "Company") develops, distributes and licenses technology that accelerates learning by improving the processing efficiency of the brain.

The Company's patented products build learning capacity by rigorously and systematically applying neuroscience-based learning principles to improve the fundamental cognitive skills required to read and learn. To facilitate the use of the Company's products, the Company offers a variety of on-site and remote professional and technical services, as well as phone, email and web-based support. The Company sells primarily to K-12 schools in the United States through a direct sales force and to parents and learning centers in approximately fifty-five countries around the world via value added resellers.

All of the Company's activities are in one operating segment. On November 14, 2019, the Company made a strategic decision to cease the Fast ForWord Home business and transition consumer opportunities to its Private Provider customers. The transition is expected to complete by September 2020.

The Company was incorporated in 1995 in the State of California and was reincorporated in 1997 in the State of Delaware.

Going Concern

The Company's cash and cash equivalents were $1.1 million at December 31, 2019, compared to cash and cash equivalents of $3.4 million at December 31, 2018. The Company's accounts receivable balance was $1.8 million at December 31, 2019 and 2018. The Company used $0.7 million and $0.2 million in cash from operations for the years ended December 31, 2019 and 2018, respectively.

Historically, the Company has used more cash in its operations during the first half of the year and has improved cash from operations in the second half. This pattern results largely from seasonally low sales in the first and fourth calendar quarters, which reflects the Company's industry pattern, and the time needed to collect on sales made towards the end of the second quarter.

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. As of the report date, the COVID-19 outbreak has impacted the Company in two main areas. First, the Company's international customers were initially affected in late December 2019 by the outbreak, which has caused their businesses to decline and therefore delay payments to the Company. Secondly, in the first quarter of 2020, many of the Company's K-12 customers have closed schools due to the outbreak. While the schools address distance learning for their students, the Company has experienced slower collections and fewer conversations for new purchases of the Company's products. The full impact of the K-12 closures is difficult to estimate.

The line of credit with our bank does not have a specific term, and the bank has the right to cancel the line, at any time, and require payment of the balance outstanding. Each year, in the second quarter, the bank conducts their review, which they do as part of their annual process to determine whether to renew the line of credit. In April 2019, the bank completed their annual review and renewed the line of credit.

On February 20, 2020, the Company completed additional financing with its current subdebt holders for $1.0 million. The Company expects to use the proceeds of this financing as additional working capital. See Note 20 for details. The Company also has taken some strong expense management actions to safeguard the business, including reducing all employee's hours and pay by 25% from April 1, 2020 through May 31, 2020.

Finally, the Company has applied for a Small Business Administration ("SBA") loan in the amount of $1.9 million from the Paycheck Protection Program ("PPP") passed by Congress on March 27, 2020. If the Company's application for the PPP loan is not approved, it will be required to raise additional financing in order to meet cash and operating needs of the business. However, there is no assurance that the Company can establish new financing that is acceptable to the Company. Even with new financing, if the Company is unable to achieve the needed levels of booked sales and cash collections, it may be required to reduce expenses to ensure that it will have sufficient liquidity to continue to fund its operations through April 14, 2021. Reducing expenses could have a negative impact on the Company's future growth potential. In addition, the Company may be required to sell assets, issue additional equity securities or incur more debt. The Company may not be able to accomplish any of these alternatives.

These conditions raise substantial doubt about the Company's ability to continue as a going concern. The 2019 financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Principles of Consolidation and Basis of Presentation

The financial statements include the consolidated accounts of the Company and its wholly-owned subsidiary in Shanghai, China through the first six months of 2018. This wholly-owned subsidiary is the Company's former development center which was discontinued in 2013 with no material activity. All significant intercompany balances and transactions have been eliminated in consolidation. In July 2018, this subsidiary was deconsolidated from its U.S. parent, which resulted in approximately $30,000 non-cash loss. All reporting periods thereafter only include the Company's U.S. entity.

Use of Estimates and Assumptions

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States ("U.S. GAAP"), requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent that there are material differences between these estimates and actual results, the Company's financial statements could be affected.

Revenue

The Company recognizes revenue using a five-step model:

- (i.) Identifying the contract(s) with a customer,
- (ii.) Identifying the performance obligations in the contract(s),
- (iii.) Determining the transaction price,
- (iv.) Allocating the transaction price to the performance obligations in the contract, and
- (v.) Recognizing revenue when, or as, the Company satisfies a performance obligation.

Nature of goods and services

The Company derives revenue from subscription fees for access to and use of its on-demand application services. Under the Company's subscription arrangements for its on-demand application services, the customer does not have the contractual right to take possession of the software at any time during the subscription period. Additionally, the Company derives revenue from the sale of perpetual licenses to its software application and from professional service and support fees.

The application of the relevant accounting standards requires the Company to exercise significant judgment related to specific transactions and transaction types. Revenue may begin to be recognized when the Company finds that collectability of substantially all consideration to which the Company is entitled and after the exchange of goods or services transferred to the customer is probable. The Company's contracts vary in combinations of products and services, which are generally capable of being separate distinct performance obligations.

The value of software licenses, subscriptions, professional services and support invoiced during a particular period is recorded as deferred revenue until recognized. Multiple contracts with the same customer are generally accounted for as separate arrangements, except in cases where the contracts are so closely related that they are effectively part of a single arrangement.

Subscription Revenue

Subscription revenue primarily includes revenue from annual or monthly customer subscriptions to our web-based applications, including Fast ForWord, Reading Assistant, and Fast ForWord Home. Subscription revenue is recognized as follows:

- On-demand application services – revenue for subscription services is recognized ratably over the term of the subscription period.
- Per student per month – student usage of any of our products during a calendar month. Revenue is recognized monthly over the period of use.
- Individual participant subscriptions – software subscriptions for a single participant. Revenue is recognized ratably over the term of the subscription period.
- International customers are charged a non-refundable minimum annual fee for student usage which is recognized ratably over the term of the subscription. Overages are billed once the minimum has been met and are recognized in the period generated.

License revenue

License revenue primarily includes revenue from the sales of perpetual licenses to our software applications including Fast ForWord and Reading Assistant. License revenue is recognized as follows:

- Perpetual licenses – software licensed on a perpetual basis. A perpetual license cannot be distinctly separated from the support contract and therefore, revenue is recognized ratably over the expected customer life for perpetual customers, which is 47 and 43 months respectively for the years ended December 31, 2019 and 2018, respectively. The customer life is revaluated at the beginning of each year and the changes are applied prospectively.

Professional and support revenue

Professional service and support revenue is derived from a combination of training, implementation, technical and professional services, online services and customer support. Training, implementation, technical and other professional services are typically sold on a per day basis. Professional services revenue is recognized as performed. Online services and customer support are recognized ratably over the service period. If standalone selling price ("SSP") does not exist for all the elements in a software arrangement other than software licenses, service revenue is recognized, after performance, over the longest contractual period in an arrangement.

Significant judgments

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as incremental costs to obtain a contract and product warranties. Our customer contracts often include promises to deliver multiple performance obligations to a customer. Determining the distinct performance obligations and the grouping of such might require significant judgment. Judgement is required to determine the SSP for distinct performance obligations identified in a customer contract. A single amount is used to estimate SSP for items that are not sold separately. The Company uses an estimated SSP when the Company sells each of the products and services separately.

Determining and Allocating the Transaction Price

Booked sales of software to the Company's school customers typically include multiple performance obligations (e.g., perpetual software licenses, support, training, implementation management, and other professional services). SSP, for each distinct performance obligation in an arrangement, is based upon the normal pricing and discounting practices for those products and services when sold separately and, for support services, is also measured by the renewal price. The Company's on-demand subscription services, support, training and implementation management services have standalone value as these services are sold separately by the Company, and the Company has established SSP for each distinct performance obligation. The Company recognizes the perpetual license using the residual method, whereby the difference between the total transaction price and the total SSP of other distinct performance obligations included in the agreement is recognized as revenue relating to the perpetual license. Discounts are allocated based on the relative SSP of the various products and services. The Company is required to exercise judgment in determining whether SSP exists based on whether the pricing for these elements is sufficiently consistent.

Contract Costs

Management expects internal sales commissions to be recoverable. Internal sales commissions are proportionally allocated based on contract booking credit as defined in employee compensation agreements. Capitalized costs attributed to a contract are allocated between performance obligations within each contract proportional to the SSP and subsequently amortized using the pattern of revenue recognition for the underlying performance obligation. These costs are included in prepaid expenses and other current assets and other assets in the accompanying balance sheets.

The Company applied the practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs include our commissions programs relating to subscription fees. The Company capitalizes commission costs associated with perpetual sales. These costs are amortized over the customer life, consistent with the amortization of deferred revenue related to perpetual sales. The amount of amortization was $93,000 and $114,000 for the years ended December 31, 2019 and 2018, respectively, which is included in sales and marketing expense in the accompanying statements of operations. There was no impairment loss in relation to these costs capitalized.

Cash and Cash Equivalents

Cash and cash equivalents, which consist of cash on deposit with banks and money market accounts, are stated at fair value.

Accounts Receivable and Allowance for Doubtful Accounts

The Company conducts business primarily with public school districts in the United States and international value added resellers. The Company records accounts receivable at the invoiced amount and the Company does not require collateral. The Company maintains an allowance for doubtful accounts for estimated losses due to the inability of customers to make payments. The allowance is determined based on any specific reserves deemed necessary and the Company's historical experience of bad debt write-offs.

Software Development Costs and Equipment

Software development costs and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from three to five years. For leased assets and leasehold improvements, depreciation is computed using the straight-line method over the shorter of the lease or the estimated useful life.

The Company capitalizes costs related to internal-use software, website application, infrastructure development and content development. Costs related to preliminary project activities and post-implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life, generally three years. The capitalized costs are included in software development costs and equipment in the accompanying balance sheets.

The Company evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. If indicators of impairment are present, estimates of future cash flows are used to test the recoverability of the asset. If the carrying amount of the asset exceeds its fair value, an impairment charge is recognized.

Long-Lived Assets

Long-lived assets, such as software development costs and equipment and purchased intangible assets, subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of an asset is measured by a comparison of the carrying amount of an asset to its estimated undiscounted future cash flows. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. For the years ended December 31, 2019 and 2018, the Company recorded no impairment charges related to long-lived assets.

Fair Value of Financial Instruments

The carrying amounts of cash equivalents, accounts receivable and accounts payable approximate fair value as they are short-term in nature or have relatively short maturities.

Concentration of Risk

Financial instruments that are potentially subject to concentrations of credit risk consist principally of cash equivalents and accounts receivable.

Cash and cash equivalents are primarily held in a major financial institution in the United States. Such deposits may be in excess of insured limits and are not insured in other jurisdictions. The Company believes that the financial institution that holds the Company's cash and cash equivalents is financially sound and, accordingly, minimal credit risk exists with respect to these assets.

Accounts receivable are primarily from sales to customers located in the United States and value-added resellers from around the world. The Company performs ongoing credit evaluations of customers. The Company does not require collateral.

An allowance for doubtful accounts is determined with respect to those accounts that have been determined to be doubtful of collection. As of December 31, 2019 and 2018, there was one customer that accounted for an aggregate of 18% and 15% of accounts receivable, respectively. There were no customers that accounted for more than 10% of revenues for the years ended December 31, 2019 and 2018.

The Company has no off-balance sheet concentration of credit risk, such as foreign exchange contracts, option contracts or other hedging arrangements.

Concentration of sales in the K-12 market potentially exposes the Company to risk. Approximately 77% and 82% of our booked sales for the years ended December 31, 2019 and 2018, respectively, came from the K-12 market in the United States and Canada. That market is characterized by its dependence on federal funding and state and local tax revenues, a political environment, particularly when large transactions are involved and a generally conservative approach to change.

All of these attributes, particularly in the current economic and political environment, can result in a time-consuming and unpredictable sales cycle for large transactions. Because of the concentration of our sales in this market, we are particularly exposed to its risks.

Accounting for Stock-Based Compensation

Stock-based compensation expense is recorded on a straight-line basis over the requisite service period and includes an estimate for forfeitures.

Advertising

Advertising costs are expensed as incurred. Advertising expenses were $0.1 million for the years ended December 31, 2019 and 2018.

Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, operating and finance lease liabilities, and operating and finance lease liabilities, net of current on the Company's balance sheets. Finance leases are included in Software development costs and equipment, operating and finance lease liabilities, and operating and finance lease liabilities, net of current portion on the Company's balance sheets.

Operating lease ROU assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. For leases without an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. The operating lease ROU asset also includes any lease payments made and initial direct costs incurred, but excludes lease incentives and variable lease payments. The Company's lease terms used in the ROU assets calculation do not include options to extend or terminate the lease. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

The Company has lease agreements with lease and non-lease components, which are generally accounted for separately. The non-lease component are generally recovery of lessor operating expense such as tax, utilities, maintenance and janitorial service.

Income Taxes

Deferred tax assets and liabilities are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the net amount expected to be realized.

Net Loss per Share

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution of securities by adding common stock equivalents (computed using the treasury stock method) to the weighted-average number of common shares outstanding during the period, if dilutive.

For the years ended December 31, 2019 and 2018, 4,104,719 and 1,355,600 stock options, respectively, were excluded from the calculation of diluted weighted shares outstanding because their effect is anti-dilutive. For the years ended December 31, 2019 and 2018, 9,375 and zero stock awards, respectively, have been excluded from the diluted weighted shares outstanding because their effect is anti-dilutive.

For the year ended December 31, 2019, 158,949 stock options, 1,335 stock awards and common stock warrants exercisable for 8,000,000 shares of common stock were excluded from the calculation of diluted net loss per share because their effect was anti-dilutive. For the year ended December 31, 2018, 490,068 stock options, 6,380 stock awards and common stock warrants exercisable for 3,000,000 shares of common stock were excluded from the calculation of diluted net loss per share because their effect is anti-dilutive.

Foreign Currency Translation

Prior to deconsolidation, the functional currency of the Company's China subsidiary was the local currency, the Chinese Renminbi. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as part of a separate component of stockholders' deficit. Foreign currency transaction gains and losses are included in the statements of operations. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate as of the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates.

Reclassifications

Upon adoption of ASU No. 2016-02, *Leases (Topic 842),* certain reclassifications have been made to the 2018 financial statement presentation to conform to the current year's presentation. Total equity and net income are unchanged due to these reclassifications.

Recent Accounting Pronouncements Adopted

In February 2016, the FASB issued Accounting Standard Update ("ASU") No. 2016-02, *Leases (Topic 842),* which amends the existing accounting standards for leases. In September 2017, the FASB issued ASU No. 2017-13 which provides additional clarification and implementation guidance on the previously issued ASU No. 2016-02. Under the new guidance, a lessee is required to recognize a lease liability and right-of-use asset for all leases with terms in excess of twelve months. The new guidance also modifies the classification criteria and accounting for sales-type and direct financing leases, and requires additional disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. Consistent with current guidance, a lessee's recognition, measurement, and presentation of expenses and cash flows arising from a lease will continue to depend primarily on its classification. In July 2018, the FASB issued ASU No. 2018-10 and ASU No. 2018-11, which further clarifies the application of the guidance issued under ASU No. 2016-02 and provides updates to transition methods and practical expedients. The accounting standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted.

The Company has adopted ASC 842, *Leases,* as of January 1, 2019 utilizing the optional method of transition, where the Company is allowed to record a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption and not restate prior periods. Additionally, the Company elected the transitional practical expedients such that the Company did not reassess whether contracts are leases, retained lease classification, and initial direct costs for leases existing prior to the adoption of the new standard. The Company made the following transitional practical expedients elections: (1) elected the short-term lease exception, (2) not elected hindsight and (3) elected to separate its non-lease components that are variable payments for its real estate leases and certain equipment leases.

On the date of adoption, the Company's total assets and total liabilities on the balance sheet increased by $1.1 million due to the recognition of right-of-use assets and lease liabilities, net of the impact of eliminating existing deferred rent liabilities and pre-paid assets related to its leasing arrangements. The adoption of ASU No. 2016-02, as amended, did not have a material impact on the Company's statements of operations or statements of cash flows.

The adoption impact on the balance sheets as of January 1, 2019 were as follows *(in thousands):*

	December 31, 2018	Adjustment due to the Adoption of Topic 842	January 1, 2019
Assets			
Software development costs and equipment, net	$ 2,775	$ 1	$ 2,776
Operating lease right-of-use assets	-	1,104	1,104
Other assets	336	(1)	335
Liabilities			
Accrued liabilities	1,433	(32)	1,401
Operating and finance lease liabilities	27	466	493
Operating and finance lease liabilities, net of current portion	23	761	784
Other liabilities	$ 90	$ (90)	$ -

In August 2018, the FASB also issued ASU NO. 2018-15, *Intangibles –Goodwill and Other –Internal-Use Software (Topic 350-40): Customer's accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.* The ASU aligns the accounting for costs incurred to implement a cloud computing arrangement that is a service arrangement with the guidance on capitalizing costs associated with developing or obtaining internal-use software and hosting arrangements that include an internal-use software license. Under ASU 2018-15, an entity would apply ASC 350-40 to determine which implementation costs related to a hosting arrangement that is a service contract should be capitalized. ASU 2018-15 is effective for fiscal years beginning after December 15, 2019. The Company has early adopted this ASU on December 31, 2019. The adoption of this standard did not have a material impact on the Company's financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Loss (Topic 326): Measurement of Credit Loss on Financial Instrument,* to replace the incurred loss impairment methodology under current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The Company will be required to use a forward-looking expected credit loss model for accounts receivables and other financial instruments. In 2019, FASB issued ASU No. 2019-04 and ASU No. 2019-05 to address implementation issues and provide transition relief, ASU No. 2019-10 and ASU No. 2019-11 to delay the effective date for certain entities and address stakeholders' specific issues about certain aspects of the amendments in ASU No. 2016-13. The standard will be effective for fiscal years beginning after December 15, 2022. The Company is currently assessing the impact of the adoption of this new accounting standard on the Company's financial statements.

In August 2018, the FASB issued ASU NO. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirement to Fair Value Measurement.* The amendments in this update modify the disclosure requirement on fair value measurements based on the concepts in the Concepts Statements, including consideration of costs and benefits. The primary focus of the standard is to improve the effectiveness of disclosures in the notes to the financial statements. ASU No. 2018-13 is effective for fiscal years beginning after December 15, 2019. The Company is currently assessing the impact of the adoption of this new accounting standard on the Company's financial statements.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. The FASB issued the changes in an effort to simplify accounting for income taxes by removing specific technical exceptions that often produce information investors have a hard time understanding. Specifically the guidance will remove the need for companies to analyze whether (1) the exception to the incremental approach for intra-period tax allocation, (2) exceptions to accounting for basis differences when there are ownership changes in foreign investments, and (3) the exception in interim period income tax accounting for year-to-date losses that exceed anticipated losses apply in a given period. ASU No. 2019-12 is effective for fiscal years beginning after December 15, 2020. The Company is currently assessing the impact of the adoption of this new accounting standard on the Company's financial statements.

2. Warrant Liability

On April 6, 2015, in connection with the Company's re-financing of its subordinated debt, the Company issued warrants ("2015 Sub-debt warrants") to purchase an aggregate of 3,000,000 shares of the Company's common stock at an initial exercise price of $0.14 per share. The warrants expire on April 6, 2020. On April 18, 2019, in connection with the restructure of its subordinated debt, the Company issued warrants ("2019 Sub-debt warrants") to purchase an aggregate 5,000,000 shares of the Company's common stock, with a warrant exercise price of $0.40 per share. The expiration date of the new warrants is September 30, 2022. Both warrants contain a cash settlement provision that may be triggered upon request by the warrant holders if the Company is acquired or in the event of a merger, as defined by the respective warrant agreement. As of December 31, 2019, these warrants were outstanding.

Under the FASB ASC Topic 815, *Derivatives and Hedging*, an equity contract that can be settled in cash at the request of the holder must be classified as an asset or a liability. The accounting guidance also requires that the warrants be re-measured at fair value at each reporting date, with the change in fair value recorded in the Company's statements of operations. See Note 3.

As of December 31, 2019 and 2018, the estimated fair value of the 2015 Sub-debt warrants was approximately $18,000 and $858,000, respectively, and was recorded as a liability on the Company's balance sheets. Upon the refinance and issuance of 2015 Sub-debt warrants on April 6, 2015, the initial estimated fair value was $261,000. For the years ended December 31, 2019 and 2018, there was a decrease of approximately $840,000 and $399,000, respectively, to the warrant liability, which was included in change in the fair value of warrants on the Company's statements of operations.
As of December 31, 2019, the estimated fair value of the 2019 Sub-debt warrants was approximately $130,000, and was recorded as a liability on the Company's balance sheets. Upon the restructure of the 2015 Sub-debt and issuance of additional warrants on April 18, 2019, the initial estimated fair value was $835,000. For the year ended December 31, 2019, there was a decrease of approximately $705,000 to the warrant liability, which was included in change in the fair value of warrants on the Company's statements of operations.

The fair value was estimated using the Black-Scholes-Merton option pricing model, which requires the input of highly subjective assumptions as determined by management. To the extent these assumptions change in future periods, the fair value of the common stock warrants may increase or decrease and the change in fair value will be recorded in the Company's results of operations.

3. Fair Value Measurements of Financial Instruments

The Company generally invests its excess cash in money market funds. Cash and cash equivalents represent liquid instruments with insignificant interest rate risk and original maturities of three months or less.

The Company has established a three-tier fair value hierarchy, categorizing the inputs used to measure fair value. The hierarchy can be described as follows: Level 1- observable inputs such as quoted prices in active markets; Level 2- inputs other than the quoted prices in active markets that are observable either directly or indirectly; and Level 3- unobservable inputs for which there is little or no market data, which require the reporting entity to develop its own assumptions.

Cash equivalents consist of money market funds that have original maturities of 90 days or less. These instruments are valued using quoted prices in active markets and are classified in Level 1 of the fair value hierarchy. At December 31, 2019 and 2018, the fair value of the money market instruments was $0.4 million and $2.8 million, respectively, accounted for at fair value on a recurring basis by level in accordance with the fair value hierarchy described above.

At December 31, 2019 and 2018, the Company had no borrowings outstanding under its credit line with the bank. The line of credit is measured at the carrying value at each reporting period and is classified under current liability as loan payable. The line of credit is classified in Level 1 in the Company's fair value hierarchy. The fair value of the line of credit approximates the carrying value.

The Company has no Level 2 financial assets or liabilities as of December 31, 2019 and 2018.

At December 31, 2019 and 2018, the Company had outstanding warrants to purchase shares of its common stock. The warrants are measured at fair value each reporting period and are classified as liabilities with an aggregate fair value of $148,000 and $858,000, respectively, at December 31, 2019 and 2018. The warrants are valued using the Black-Scholes-Merton option pricing model using valuation assumptions determined by management and are classified in Level 3 in the Company's fair value hierarchy.

The Company used the following assumptions when determining the fair value of the 2015 Sub-debt warrants:

	December 31, 2019	December 31, 2018
Expected life (in years)	0.26	1.26
Risk-free interest rate	1.55 %	2.59 %
Dividend yield	0 %	0 %
Expected volatility	100 %	100 %

The Company assessed the sensitivity of the fair value of the 2015 Sub-debt warrants with respect to the assumptions above and noted a 10% decrease in its common stock price would decrease the fair value of the warrants by 33%, or $6,000, and a 10% increase in its common stock would increase the fair value of the warrants by 50%, or $9,000, as of December 31, 2019.

The Company used the following assumptions when determining the fair value of the 2019 Sub-debt warrants:

	December 31, 2019	April 18, 2019
Expected life (in years)	2.75	3.45
Risk-free interest rate	1.61 %	2.37 %
Dividend yield	0 %	0 %
Expected volatility	100 %	100 %

The Company assessed the sensitivity of the fair value of the 2019 Sub-debt warrants with respect to the assumptions above and noted a 10% decrease in its common stock price would decrease the fair value of the warrants by 15%, or $20,000, and a 10% increase in its common stock would increase the fair value of the warrants by 19%, or $25,000, as of December 31, 2019.

The following table summarizes the changes in fair value for the outstanding common stock warrants (*in thousands*):

	Changes in Fair Value of Common Stock Warrants
Balance at December 31, 2018	$ 858
Issuance of warrants with subordinated debt restructure	835
Total changes in fair value	(1,545)
Balance at December 31, 2019	$ 148

The following is a summary of the Company's financial assets as of December 31, 2019 and 2018 that are accounted for at fair value on a recurring basis by level in accordance with the fair value hierarchy described above (*in thousands):*

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market instruments	$ 419	$ -	$ -	$ 419
Liabilities:				
Common stock warrants	$ -	$ -	$ 148	$ 148

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market instruments	$ 2,776	$ -	$ -	$ 2,776
Liabilities:				
Common stock warrants	$ -	$ -	$ 858	$ 858

4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following (*in thousands*):

	December 31,	
	2019	2018
Prepaid expenses	$ 297	$ 253
Deferred commissions	66	81
Tax refund receivable	176	164
Other receivables	60	62
Total prepaid expenses and other current assets	$ 599	$ 560

5. Software Development Costs and Equipment

Software development costs and equipment consist of the following (*in thousands*):

	December 31,	
	2019	2018
Computer equipment and software	$ 6,443	$ 6,610
Software development costs	540	173
Office furniture and equipment	50	50
Leasehold improvements and leased equipment	167	408
Total software development costs and equipment	7,200	7,241
Less: Accumulated depreciation and amortization	(4,379)	(4,466)
Total software development costs and equipment, net	$ 2,821	$ 2,775

For the years ended December 31, 2019 and 2018, the Company capitalized $1.1 million and $1.0 million, respectively, of internal-use software and website development costs. Depreciation and amortization expense for the years ended December 31, 2019 and 2018 was $1.1 million and $0.8 million, respectively, of which $1.0 million and $0.7 million, respectively, was for the amortization of internal-use software and website development costs.

For the years ended December 31, 2019 and 2018, as a result of annual impairment review, the Company disposed $0.9 million and $1.6 million of fully amortized or depreciated software and computer equipment. The majority of these assets were retired or expired internal-use cloud computing software licenses, related development costs and retired computer equipment. The Company recorded no loss from the disposal in either year.

6. Other Assets

Other assets consist of the following (*in thousands*):

	December 31,	
	2019	2018
Long-term lease deposits	$ 72	$ 72
Deferred commissions, net of current portion	63	76
Tax refund receivable and other	-	188
Total other assets	$ 135	$ 336

7. Warranties and Indemnification

The Company generally provides a warranty that the Company's software products will substantially operate as described in the manuals and guides that accompany the software for a period of 90 days. The warranty does not apply in the event of misuse, accident, and certain other circumstances. To date, the Company has not incurred any material costs associated with these warranties and has no accrual for such items as of December 31, 2019 and 2018.

From time to time, the Company enters into contracts that require the Company, upon the occurrence of certain contingencies, to indemnify parties against third party claims. These contingent obligations primarily relate to (i) claims against the Company's customers for violation of third party intellectual property rights caused by the Company's products; (ii) claims resulting from personal injury or property damage resulting from the Company's activities or products; (iii) claims by the Company's office Lessor arising out of the use of the premises; and (iv) agreements with the Company's officers and directors under which the Company may be required to indemnify such persons for liabilities arising out of their activities on behalf of the Company. No liabilities have been recorded for these obligations as of December 31, 2019 and 2018.

8. Subordinated Debt

On April 6, 2015, the Company re-financed its subordinated debt and issued $5.0 million of subordinated debt securities ("2015 sub-debt") and warrants to purchase an aggregate of 3,000,000 shares of the Company's common stock at an initial exercise price of $0.14 per share to a group of its then current investors and one new investor. The new subordinated debt proceeds were used for the repayment of outstanding subordinated debt, working capital and general corporate purposes. The notes issued pursuant to the subordinated note and warrant purchase agreement initially bore simple interest at a rate of 12% per annum. The full principal was initially due on maturity on April 6, 2018 with the option of two one-year extensions. The Company exercised the first and second extensions in April 2018 and 2019, respectively, along with the New Notes as disclosed below. Upon the extension in April 2018, the interest rate increased to 15% per annum. The Company will pay accrued interest in arrears on each August 31 and November 30 and the final payment date. The Note and Warrant Purchase Agreement ("2015 Agreement") contains customary affirmative and negative covenants, including notification and information covenants and covenants restricting the Company's ability to merge or liquidate, incur debt, dispose of assets, incur liens, declare dividends or enter into transactions with affiliates. During the years ended December 31, 2019 and 2018, the Company was in compliance with all covenants related to the 2015 sub-debt. The 2015 Agreement also requires the Company to repay the notes upon the occurrence of a change of control (as defined in the 2015 Agreement) at 101% of the principal amount thereof plus accrued and unpaid interest.

The total value allocated to the 2015 sub-debt warrants was approximately $261,000 and was recorded as a debt discount against the proceeds of the notes and was amortized to interest expense over the three-year term of the notes. The aggregate debt issuance costs associated with the 2015 sub-debt financing were $47,000, which were comprised of outside legal costs. These costs were recorded as a reduction to the 2015 sub-debt and were amortized as interest expense over the life of the notes. For the years ended December 31, 2019 and 2018, the Company recorded amortization expense related to the debt discount and issuance costs of zero and $19,000, respectively.

On July 13, 2017, the Company entered into the First Omnibus Amendment (the "Amendment") between the Company and the 2015 sub-debt holders. The Amendment allowed the Company to issue an additional $1,000,000 in Promissory Notes ("New Notes") to existing investors. The New Notes are subject to the same terms and conditions as the 2015 sub-debt, except as otherwise set forth in the Amendment as follows: (1) no additional warrants were issued in respect of the New Notes; (2) the New Notes were issued at 98%, with original issue discount of 2%; and (3) as long as the Company is not in default, the Amendment enables the Company to pay the New Notes early without making pro rata payments on the 2015 sub-debt. The loan proceeds were used for working capital and general corporate purposes. The New Notes initially bore simple interest at a rate of 12% per annum with full maturity due on April 6, 2018, with the option of two one-year extensions. On April 6, 2018 and April 3, 2019, the Company exercised the first and second extensions of the New Notes, along with the 2015 sub-debt discussed above and the interest rate increased to 15% per annum. The aggregate debt issuance costs associated with completing the New Notes and related amendments were approximately $44,000, which are comprised of outside legal costs. These costs were recorded as a reduction of the New Notes and were amortized as interest expense over the original nine-month term of the New Notes. For the years ended December 31, 2019 and 2018, the Company recorded amortization expense related to the debt discount and issuance costs of zero and $26,000, respectively.

On April 22, 2019, the Company entered into an amendment ("2019 sub-debt restructure") to its 2015 sub-debt and New Notes, with an effective date of April 18, 2019. The material terms of the amendment are: (1) the Final Payment for the $6,000,000 aggregate principal amount of subordinated debt was extended from April 5, 2020 to October 31, 2022; (2) the annual interest rate was reduced from 15% to 9%, effective April 19, 2019; and (3) the Company issued to the holders of the 2015 sub-debt and New Notes new warrants to purchase an aggregate 5,000,000 shares of the Company's common stock, with a warrant exercise price of $0.40 per share. The expiration date of the new warrants is September 30, 2022.

The Company evaluated the modification pursuant to ASC 470-60, *Troubled Debt Restructuring by Debtors*, and ASC 470-50, *Modification and Extinguishment*. The indicators of financial difficulty contained in ASC 470-60 were reviewed and it was concluded that the Company was experiencing financial difficulty because there was no assurance that the Company would have sufficient cash flows to service the debt through its maturity and the Company could not obtain funds at lower than market rate from sources other than existing creditors. The Company then proceeded to assess whether the creditors granted a concession and determined that a concession was granted because the effective borrowing rate on the restructured sub-debt is lower than the effective borrowing rate of the old sub-debt. Since both conditions are met, the troubled debt restructuring model contained in ASC 470-60 was applied. The carrying amount of the payable including both principal and accrued interest at date of amendment was not adjusted and became the restructured sub-debt principal. The effects of the changes are reflected in future periods by computing the constant effective interest rate and applying it to the amendment date carrying amount of the payable each period until maturity.

The total value allocated to the 2019 sub-debt warrants was approximately $835,000 and was recorded as a debt discount against restructured sub-debt and is being amortized to interest expense over the life of modified term. See Note 2. As of December 31, 2019, the Company recorded amortization expense related to the debt discount of $153,000.

The Company's original and restructured subordinated debt was comprised of the following (*in thousands*):

	December 31, 2019		December 31, 2018	
2015 Sub-debt	$	5,008	$	5,000
New Notes		1,001		1,000
Debt discount		(682)		-
Total subordinated debt	$	5,327	$	6,000

See Note 20 for additional subordinated debt financing completed on February 20, 2020.

9. Loan Payable

On June 23, 2014, the Company executed a Business Financing Agreement ("line of credit") with the bank. This agreement provides the Company a line of credit of $2 million secured by the Company's personal property and related assets. Advances on the line of credit are permitted up to 80% of eligible accounts receivable. The line of credit bears an interest rate of prime plus 3% per annum. The line of credit is a senior credit facility to the Subordinated Debt and was originally scheduled to terminate on April 5, 2015. Borrowings under the line of credit are subject to reporting covenants requiring the remittance of financial statements and supporting working capital reports to the bank.

On April 6, 2015, the Company extended the line of credit with the bank, which is subject to annual renewal in conjunction with the refinance efforts as disclosed in Note 8. In April 2019, the bank completed their annual review and renewed the line of credit.

As of December 31, 2019 and 2018, the Company had zero balance in borrowings under its line of credit and was in compliance with all financial reporting covenants.

10. Contract Balances

The following table provides information about receivables, assets and liabilities from contracts with customers (*in thousands*):

Contract balances	**December 31,**			
	2019		**2018**	
Receivables	$	1,824	$	1,837
Deferred commissions, current		66		81
Deferred commissions, non-current		63		76
Deferred revenue, current		9,058		9,923
Deferred revenue, non-current	$	2,156	$	2,415

The amount of revenue recognized that was included in the deferred revenue balance at the beginning of the period was $9.9 million and $10.1 million as of December 31, 2019 and 2018, respectively.

The contract assets are transferred to receivables when the rights become unconditional. The contract liabilities primarily relate to the advance consideration received from customers, for which revenue is subsequently recognized ratably.

Significant changes in the contract asset balances during the period are as follows *(in thousands)*:

	December 31,			
	2019		**2018**	
Balance as of January 1	$	157	$	207
Commission recognized that was included in the contract asset balance at the beginning of the period		(81)		(106)
Increases due to commissions capitalized, excluding amounts recognized as expense during the period		53		56
Ending balance	$	129	$	157

Significant changes in the contract liabilities balances during the period are as follows *(in thousands)*:

	December 31,			
	2019		**2018**	
Balance as of January 1	$	(12,338)	$	(12,912)
Revenue recognized that was included in the contract liability balance at the beginning of the period		9,939		10,115
Increases due to book sales, excluding amounts recognized as revenue during the period		(8,815)		(9,541)
Ending balance	$	(11,214)	$	(12,338)

Transaction price allocated to the remaining performance obligations

As of December 31, 2019, $11.2 million of revenue from remaining performance obligations is expected to be recognized, of which the Company expects to recognize approximately 81% over the next 12 months, with the remainder recognized thereafter.

Significant financing component

Payment terms and conditions vary by contract type. The Company's contracts generally do not include a significant financing component whereby customers most often are issued an invoice for the full fee promptly upon receipt of signed final proposal. The primary purpose of the invoicing terms is neither to receive financing, nor to provide customers with financing. When a payment term is greater than 1 year, the Company will impute interest if the amount is material. The Company recorded imputed interest of $16,300 and zero for the years ended December 31, 2019 and 2018, respectively.

11. Income Taxes

Substantially all loss before provision for income taxes is derived from the United States.

The components of the provision for income taxes are as follows (*in thousands*):

	Year Ended December 31,	
	2019	**2018**
Current:		
State	$ 8	$ 6
Total current	$ 8	$ 6
Total provision for income taxes	$ 8	$ 6

Differences between income taxes calculated using the federal statutory income tax rate and the provision for income taxes were as follows (*in thousands):*

	Year Ended December 31,	
	2019	**2018**
Computed tax at statutory rate	$ (70)	$ (183)
State taxes, net of federal benefit	5	3
Non deductible stock-based compensation	42	29
Fair value warrants	(320)	(62)
Other nondeductible expenses	19	22
Stock-based compensation true-ups	9	(10)
Net operating loss write-offs	1,351	-
Prior year true-ups	2	-
Research and development and other credits	6	(75)
Movement in valuation allowance	(1,036)	282
Provision for income taxes	$ 8	$ 6

Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company's deferred tax assets (liabilities) are as follows (*in thousands*):

	Year Ended December 31,	
	2019	**2018**
Deferred tax assets and liabilities:		
Net operating loss carryforwards	$ 21,296	$ 22,030
Deferred revenue	595	688
Research credit carryforwards	4,871	4,757
Intangibles assets (excluding goodwill)	320	427
Goodwill	226	303
Depreciable assets	(44)	16
Other	267	246
Total gross deferred tax assets	27,531	28,467
Valuation allowance	(27,531)	(28,467)
Total Net deferred tax asset	$ -	$ -

As of December 31, 2019, the Company has U.S. federal net operating loss carryforwards of approximately $6.9 million, which can be carried forward indefinitely. As of December 31, 2019, the Company also has U.S. federal and state net operating loss carryforwards of approximately $84 million and $33 million, respectively. These U.S. federal net operating loss carryforwards will expire at various dates beginning in 2020 through 2037, if not utilized. State net operating loss carryforwards will expire at various dates beginning in 2020 through 2039.

As of December 31, 2019, the Company has U.S. federal and state tax credit carryforwards of approximately $2.9 million and $4.4 million, respectively. The federal credit will expire at various dates beginning in 2020 through 2039, if not utilized. California state research and development credits can be carried forward indefinitely.

The corporate Alternative Minimum Tax ("AMT") has been repealed for tax years beginning after December 31, 2017. Taxpayers with AMT credit carryforwards that have not yet been used may claim a refund in future years for those credits even though no income tax liability exists. Companies can continue using AMT credits to offset any regular income tax liability in years 2018 through 2020, with 50 percent of remaining AMT credits refunded in each of the 2018, 2019, and 2020 tax years and all remaining credits refunded in tax year 2021. The pass of Coronavirus Aid, Relief, and Economic Security Act (The "CARES Act") on March 27, 2020 accelerates the refund schedule which permits the taxpayers to claim the refund in full in either 2018 or 2019. As a result, the Company's remaining AMT credits mentioned above will all be refunded in year 2020 after filing of the 2019 tax return.

Net operating loss carryforwards and credit carryforwards reflected above could be limited due to ownership changes as provided in the Internal Revenue Code and similar state provisions.

The Company follows provisions of ASC 740-10, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB ASC 740-10*. ASC 740-10 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities.

Interest and penalty costs related to unrecognized tax benefits are classified as a component of provision for income taxes in the accompanying statements of operations and the corresponding liability in accrued liabilities in the accompanying balance sheets.

The Company files U.S. federal and state income tax returns. Material jurisdictions are Federal and California tax returns, which remain open to examination by the appropriate governmental agencies for tax years 2000 to 2019. The federal and state taxing authorities may choose to audit tax returns for tax years beyond the statute of limitation period due to significant tax attribute carryforwards from prior years, making adjustments only to carryforward attributes. The Company is not currently under audit in any major tax jurisdiction.

A reconciliation of the beginning and ending amount of the liability for unrecognized income tax benefits during the years ended December 31, 2019 and 2018 is as follows (*in thousands*):

	Year Ended December 31,			
	2019		2018	
Balance at January 1	$	1,726	$	1,734
Increases for tax positions related to the current year		75		62
Decreases related to lapse of statute of limitations		(38)		(70)
Balance at December 31	$	1,763	$	1,726

12. Stock-Based Compensation

Stock-Based Compensation Plans

In May 1999, the Company's stockholders approved the 1999 Equity Incentive Plan. The total number of shares authorized for issuance under the plan is 7,742,666. Restricted stock units awarded under this plan generally vest over four years of continuous service in annual or semi-annual installments. Time based option awards have generally been granted with an exercise price equal to or greater than the market price of the Company's common stock at the date of grant, and generally vest based on four years of continuous service with a ten-year contractual term. In March 2019, 6,000,000 shares were added to the 1999 Equity Incentive plan, increasing the total number of shares authorized for issuance to 13,742,666. In April 2019, the Company began to grant performance based option awards, which will vest if the performance condition is satisfied. Those options were granted with an exercise price greater than the market price of the Company's common stock at the date of grant and have a ten-year contractual term.

Stock-Based Compensation Expense

Compensation expense is recognized for the fair values of stock-based awards, which typically have graded vesting, on a straight-line basis over the requisite service period.

The Company elects to estimate forfeitures at the time of the grant. The estimates are revised in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records stock-based compensation expense only for those awards that are expected to vest. The following table summarizes the stock-based compensation expense recorded for the years ended December 31, 2019 and 2018 (*in thousands*):

	Year Ended December 31,			
	2019		2018	
Cost of revenues	$	12	$	2
Sales and marketing		66		60
Research and development		38		23
General and administrative		300		90
Total stock-based compensation expense	$	416	$	175

Valuation of Stock Option Awards

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option pricing model with subjective assumptions, including expected stock price volatility, the expected life of each award and estimated pre-vesting forfeitures noted in the table below:

Expected volatility – Based on the historical prices of the Company's common stock over the expected life of each option.
Expected life – Based on the history of option exercise and cancellation activity.

Risk-free interest rate – Based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the options.

Dividend yield – As the Company has not paid, nor does it currently plan to pay dividends in the future, the assumed dividend yield is zero.

Estimated forfeiture rate – Based on the history of option forfeitures and expectations of future pre-vesting termination behavior.

The fair value of time based stock options granted was estimated using the following weighted-average assumptions:

	Year Ended December 31,	
	2019	**2018**
Expected life (in years)	6.2	6.0
Risk-free interest rate	2.1%	2.6%
Dividend yield	0%	0%
Expected volatility	195%	179%
Estimated forfeiture rate	3.3%	4.6%

The fair value of performance based stock options granted was estimated using the following weighted-average assumptions:
`

	Year Ended December 31,	
	2019	**2018**
Expected life (in years)	2.9	N/A
Risk-free interest rate	2.3%	N/A
Dividend yield	0%	N/A
Expected volatility	228%	N/A
Estimated forfeiture rate	0%	N/A

Summary of Stock Options

The following table summarizes all stock option activity under the Company's stock-based compensation plan for the years ended December 31, 2019 and 2018:

	Number of Options	Weighted-Average Exercise Price Per Share		Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (*in thousands*)	
Outstanding at December 31, 2017	2,411,493	$	0.72	6.9		
Granted	307,814		0.61			
Forfeited	(71,983)		0.46			
Expired	(54,581)		0.43			
Outstanding at December 31, 2018	2,592,743	$	0.72	5.9	$	129
Granted	3,356,511		0.50			
Forfeited	(71,356)		0.49			
Expired	(447,394)		0.90			
Outstanding at December 31, 2019	5,430,504		0.57	6.5	$	-
Vested and expected to vest at December 31, 2019	5,285,025		0.57	6.5	$	-
Exercisable at December 31, 2019	2,618,473	$	0.63	5.9	$	-

The aggregate intrinsic value of options outstanding at December 31, 2019 is calculated as the difference between the exercise price of the underlying options and the market price of the Company's common stock for shares that had exercise prices that were lower than the $0.09 market price of the Company's common stock at December 31, 2019 ("in the money options"). There were no options exercised during the years ended December 31, 2019 and 2018. The fair value of options vested during the years ended December 31, 2019 and 2018 was $0.3 million and $0.2 million, respectively. The weighted-average grant date fair value of time based options granted during the years ended December 31, 2019 and 2018 was $0.27 and $0.59 per share, respectively. The weighted-average grant date fair value of performance based options granted during the years ended December 31, 2019 and 2018 was $0.31and zero per share, respectively.

As of December 31, 2019, total unrecognized compensation cost related to stock options granted under the Company's plan was $0.5 million. The Company expects this cost to be recognized over a weighted-average period of 2.6 years.

Summary of Restricted Stock Awards

The following table summarizes all restricted stock awards ("RSAs") activity under the Company's stock-based compensation plan for the years ended December 31, 2019 and 2018:

	Number of Shares		Aggregate Intrinsic Value (*in thousands*)	
Expired		0		
Outstanding at December 31, 2017		-	$	-
Awarded		-		
Released (vested)		-		
Outstanding at December 31, 2018		-	$	-
Awarded		206,022		
Released (vested)		(206,022)		
Outstanding at December 31, 2019	$	-	$	-

Summary of Restricted Stock Units

The following table summarizes all restricted stock units ("RSUs") activity under the Company's stock-based compensation plan for the years ended December 31, 2019 and 2018:

	Number of Shares	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (*in thousands*)
Outstanding at December 31, 2017	15,620	0.8	$ 8
Awarded	9,375		
Released (vested)	(7,770)		
Forfeited	(4,725)		
Outstanding at December 31, 2018	12,500	0.8	$ 5
Awarded	14,374		
Released (vested)	(10,619)		
Forfeited	0		
Outstanding at December 31, 2019	16,255	0.9	$ 1

The fair value of these RSUs and RSAs is calculated based upon the fair market value of the Company's stock at the date of grant, less an estimate of pre-vesting forfeitures. The weighted-average grant-date fair value of RSUs and RSAs awarded during the years ended December 31, 2019 and 2018 was $0.32 and $0.52 per share, respectively, and the fair value of RSUs and RSAs that vested during the years ended December 31, 2019 and 2018 was $71,000 and $3,700, respectively. As of December 31, 2019, total unrecognized compensation cost related to RSUs was $4,700. The Company expects this cost to be recognized over a weighted-average period of 1.8 years.

Disclosures Pertaining to All Stock-Based Compensation Plans

Cash received under all share-based payment arrangements for the years ended December 31, 2019 and 2018 was zero, related to exercise of stock options. The Company issues new shares upon option exercise and does not repurchase or issue treasury shares.

13. Accrued Liabilities

Accrued liabilities consist of the following (*in thousands*):
`

	December 31, 2019	December 31, 2018
Accrued vacation	$ 571	$ 545
Accrued commission and bonus	300	365
Accrued wage and severance	44	74
Accounts payable accruals and other accrued liabilities	240	449
Total accrued liabilities	$ 1,155	$ 1,433

14. Commitments and Contingencies

Royalty

The Company is committed to pay minimum royalties to a third-party publisher for content in the Company's products. At December 31, 2019, the Company's future minimum payments due under specific contractual obligations were as follows (*in thousands*):

	2020	2021	2022	2023	2024	Thereafter	Total
Minimum royalty payments	$ 16	$ 16	$ 16	$ 16	$ 16	$ 33	$ 113
Total obligations	$ 16	$ 16	$ 16	$ 16	$ 16	$ 33	$ 113

Leases

The Company has operating and finance leases for corporate offices, computers and other equipment. The leases have remaining lease terms ranging from less than 1 year to 3 years, some of which may include options to extend the leases for up to 5 years.

The components of lease expense were as follows *(in thousands)*:

	December 31, 2019
Finance lease expense:	
Amortization of right-of-use-assets	$ 24
Interests on lease liabilities	7
Total finance lease expense	31
Operating lease expense	488
Short-term lease expense	4
Variable lease expense	41
Total lease expense	$ 564

Supplemental cash flow information related to leases were as follows *(in thousands):*

	December 31, 2019
Cash paid for amounts included in the measurement of liabilities for finance leases:	
Operating cash flow	$ 7
Financing cash flow	39
Cash paid for amounts included in the measurement of liabilities for operating leases:	
Operating cash flow	477
Right-of-use assets obtained in exchange for lease liabilities	
Finance leases	$ 44

Supplemental balance sheet information related to leases were as follows *(in thousands):*

		December 31, 2019
Operating Leases		
Operating lease right-of-use-assets	$	703
Operating lease liabilities		435
Operating lease liabilities, net of current		402
Total operating lease liabilities	$	837
Finance Leases		
Software development costs and equipment	$	71
Accumulated amortization		(23)
Software development costs and equipment, net	$	48
Finance lease liabilities		27
Finance lease liabilities, net of current		28
Total finance lease liabilities	$	55

Weighted Average Remaining Lease Term		
Operating lease	2.6	years
Finance Leases	2.0	years
Weighted Average Discount Rate		
Operating lease	8.3%	
Finance Leases	9.9%	

Future minimum lease payments under non-cancellable leases as of December 31, 2019 were as follows *(in thousands):*

		Finance Lease		Operating Lease
2020	$	31	$	488
2021		27		285
2022		3		144
Total lease payments		61		917
Less imputed interest		(6)		(80)
Present value of lease liabilities	$	55	$	837

As of December 31, 2019, the Company has no additional operating and finance leases that have not yet commenced.

15. Common Stock

At December 31, 2019, the Company had reserved shares of common stock for future issuance as follows:

	December 31, 2019
Stock options outstanding	5,430,504
Restricted stock units/awards outstanding	16,255
Stock options available for future grants	3,156,987
Warrants	8,000,000
Total	16,603,746

16. Disaggregation of Revenue

In the following tables, revenue was disaggregated by revenue channel, major products and services and duration of contract *(in thousands):*

Major products and services	Year ended December 31,			
	2019		2018	
Subscription revenue	$	8,846	$	8,931
License revenue		1,988		2,462
Support		3,442		3,886
Professional services		1,523		1,465
Total	$	15,799	$	16,744

Revenue channel	Year ended December 31,			
	2019		2018	
K-12 School Districts	$	12,664	$	13,495
Fast ForWord Home		1,209		1,255
International		1,005		1,088
Private Provider		848		861
Other		73		45
Total	$	15,799	$	16,744

Contract duration	Year ended December 31,			
	2019		2018	
One year or less	$	12,445	$	12,764
Multiple year		1,525		1,560
Perpetual		1,771		2,381
Other		58		39
Total	$	15,799	$	16,744

17. Employee Retirement and Benefit Plan

The Company has a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code, which covers substantially all employees. The Company started to make employer match contributions in 2019 and made $44,000 contributions to plan participants for the year ended December 31, 2019.

18. Related Party Transactions

On December 20, 2013, the Company and Posit Science Corporation (“PSC”) executed Amendment No. 3 to the Scientific Learning Corporation License Agreement, effective as of December 31, 2003. A co-founder, stockholder, and former member of the Board of Directors of the Company are a co-founder, officer, director and substantial stockholder of PSC. The original License Agreement granted PSC licenses in the Health Field (as defined in the License Agreement) to issued and pending patents held by the Company. PSC’s licenses in the Health Field to many of the patents were exclusive. Under the Amendment, PSC agreed to make the exclusive licenses to 16 of the patents non-exclusive. PSC also agreed to amend the definition of Health Field as it applies to all non-exclusive licenses so as to reserve for the Company the field of Fitting of Hearing Aids and Cochlear Implants (as defined in the Amendment). In exchange for the changes in the license terms set forth in the Amendment, the Company agreed to a 90% reduction in PSC’s annual minimum royalty payment of $150,000 and in the Applicable Base Royalty Percentage of New Sales set forth in the License Agreement. Accordingly, the annual minimum royalty payment is now $15,000 per year and the Applicable Base Royalty Percentage is now 0.4% of Net Sales. The Company has a 3.5% equity interest in PSC. The royalty income recorded from PSC was $15,000 for the years ended December 31, 2019 and 2018.

On January 1, 2017, the Company revised the agreement with a board member to reduce his consulting fee to $12,000 per year. For the years ended December 31, 2019 and 2018, the Company incurred $12,000 in consulting fees with the board member and had a payable due to him of $1,000 as of December 31, 2019 and 2018.

In July 2018, the Company executed a consulting agreement with an education technology consulting and service provider to assist with conversion of the remaining Fast ForWord products from Flash to HTML5 over an 18-month period in the amount of $594,000. The Company’s Chairman of the Board is a board member of this service provider. The Board of Directors acknowledged that the Chairman is a director of service provider and, accordingly, has a potential conflict of interest in connection with the contemplated transaction; however, after reviewing the terms of the statement of work (“SOW”), the Board determined the SOW to be fair and reasonable and in the best interest of the Company, and waived any potential conflict of interest. The project work commenced in September 2018. For the years ended December 31, 2019 and 2018, the Company incurred $369,000 and $132,000 in consulting fees with the service provider and had payables due to this service provider of $35,000 and $66,000 as of December 31, 2019 and 2018, respectively.

19. Interim Financial Information (unaudited)

Quarterly financial data (*in thousands, except per share amounts):*

	Three Months Ended				
	March 31	**June 30**	**September 30**	**December 31**	**Total**
Fiscal Year 2019:					
Total revenues	$ 4,092	$ 3,993	$ 3,852	$ 3,862	$ 15,799
Gross profit	$ 3,036	$ 2,982	$ 2,741	$ 2,657	$ 11,416
Net loss	$ (41)	$ (62)	$ (78)	$ (158)	$ (339)
Basic and diluted net loss per share:	$ (0.00)	$ (0.00)	$ (0.00)	$ (0.01)	$ (0.01)
Fiscal Year 2018:					
Total revenues	$ 4,217	$ 4,198	$ 4,133	$ 4,196	$ 16,744
Gross profit	$ 3,217	$ 3,341	$ 3,125	$ 3,129	$ 12,812
Net income (loss)	$ (673)	$ (176)	$ (79)	$ 55	$ (873)
Basic and diluted net income (loss) per share:	$ (0.02)	$ (0.01)	$ (0.00)	$ 0.00	$ (0.03)

20. Subsequent Events

The Company has evaluated subsequent events through the filing date of this report, and determined that there have been no events that have occurred that would require adjustments to our disclosures in the financial statements except for the following:

On February 20, 2020, the Company entered into the Second Omnibus Amendment (the "Amendment") between the Company, the 2015 sub-debt holders and two additional members of the Company's Board of Directors as new subordinated debt purchasers (collectively, "Purchasers"). The Company and the Purchasers also entered into Amendment Number Two to the Amended and Restated Subordination Agreement and Joinder (the "Subordination Amendment") with the bank. The Amendment allowed the Company to issue a total of $1,047,368 in additional Promissory Notes ("2020 New Notes") to a group of its current investors and the majority of its Board of Directors and amended the Maximum Subordinated Debt Amount (as defined in the Agreement) from $6,000,000 to $7,047,368. The 2020 New Notes are subject to the same terms and conditions as defined in 2019 sub-debt restructure except as otherwise set forth in the Amendment as follows: (1) no additional warrants were issued in respect of the 2020 New Notes; and (2) the 2020 New Notes were issued at 95%, with original issue discount of 5%. The loan proceeds will be used for working capital and general corporate purposes. The notes bear a simple interest rate of 9% per annum with full maturity due on October 31, 2022.

Disclosure Statement Pursuant to the OTC Pink Basic Disclosure Guidelines

Scientific Learning Corp.
A Delaware Corporation
1956 Webster St, Suite 200
Oakland, California 94612
888-665-9707
www.scilearn.com
info@scilearn.com
SIC Code – 7272 Educational Computer Software

Annual Report
For the Period Ending: December 31, 2019
(the "Reporting Period")

As of December 31, 2019, the number of shares outstanding of our Common Stock was: 27,769,673
As of September 30, 2019, the number of shares outstanding of our Common Stock was: 27,762,445

Indicate by check mark whether the company is a shell company (as defined in Rule 405 of the Securities Act of 1933 and Rule 12b-2 of the Exchange Act of 1934):

Yes: ☐ No: ☒ (Double-click and select "Default Value" to check)

Indicate by check mark whether the company's shell status has changed since the previous reporting period:

Yes: ☐ No: ☒

Indicate by check mark whether a Change in Control[1] of the company has occurred over this reporting period:

Yes: ☐ No: ☒

1) Name of the issuer and its predecessors (if any)

In answering this item, please also provide any names used by predecessor entities and the dates of the name changes.

N/A

Date and state (or jurisdiction) of incorporation (also describe any changes to incorporation since inception, if applicable) Please also include the issuer's current standing in its state of incorporation (e.g. active, default, inactive):

The Company was incorporated in 1995 in the State of California and was reincorporated in 1997 in the State of Delaware.

[1] "Change in Control" shall mean any events resulting in:

(i) Any "person" (as such term is used in Sections 13(d) and 14(d) of the Exchange Act) becoming the "beneficial owner" (as defined in Rule 13d-3 of the Exchange Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the total voting power represented by the Company's then outstanding voting securities;

(ii) The consummation of the sale or disposition by the Company of all or substantially all of the Company's assets;

(iii) A change in the composition of the Board occurring within a two (2)-year period, as a result of which fewer than a majority of the directors are directors immediately prior to such change; or

(iv) The consummation of a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or its parent) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity or its parent outstanding immediately after such merger or consolidation.

Current Standing: Active

Has the issuer or any of its predecessors ever been in bankruptcy, receivership, or any similar proceeding in the past five years?

Yes: ☐ No: ☒

2) Security Information

Trading symbol:	SCIL	
Exact title and class of securities outstanding:	Common Stock	
CUSIP:	808760102	
Par or stated value:	Par value of $0.001	
Total shares authorized:	60,000,000	as of date: 12/31/2019
Total shares outstanding:	27,769,673	as of date: 12/31/2019
Number of shares in the Public Float[2]:	12,510,440	as of date: 12/31/2019
Total number of shareholders of record:	112	as of date: 12/31/2019

Additional class of securities (if any): N/A

Transfer Agent

Name: Continental Stock Transfer & Trust Company
Phone: 212-509-4000
Email: cstmail@continentalstock.com

Is the Transfer Agent registered under the Exchange Act?[3] Yes: ☒ No: ☐

Describe any trading suspension orders issued by the SEC concerning the issuer or its predecessors:

NONE

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months:

NONE

3) Issuance History

The goal of this section is to provide disclosure with respect to each event that resulted in any direct changes to the total shares outstanding of any class of the issuer's securities **in the past two completed fiscal years and any subsequent interim period**.

Disclosure under this item shall include, in chronological order, all offerings and issuances of securities, including debt convertible into equity securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services. Using the tabular format below, please describe these events.

[2] "Public Float" shall mean the total number of unrestricted shares not held directly or indirectly by an officer, director, any person who is the beneficial owner of more than 10 percent of the total shares outstanding (a "control person"), or any affiliates thereof, or any immediate family members of officers, directors and control persons.

[3] To be included in the Pink Current Information tier, the transfer agent must be registered under the Exchange Act.

A. Changes to the Number of Outstanding Shares

Check this box to indicate there were no changes to the number of outstanding shares within the past two completed fiscal years and any subsequent periods: ☐

Date of Transaction	Transaction Type	No. of Shares Issued (or Cancelled	Class of Securities	Value of Shares issued ($/share)	Were the shares issued at a discount to market price at the time of issuance?	Entity	Reasons for share issuance or Nature of Provided	Restricted (Yes/No) as of this filing	Exemption or Registration Type?
Number of Shares outstanding as of December 31, 2017	**Opening Balance** Common:	**24,670,904**							
1/12/2018	New issuance	320,000	Common	$ 0.6250	No	Bowen, Robert C.	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	320,000	Common	$ 0.6250	No	Moorhead III, Rodman W.	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	16,000	Common	$ 0.6250	No	Thomas, Jeffery D.	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	16,000	Common	$ 0.6250	No	Moses, Michael A.	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	8,000	Common	$ 0.6250	No	Nathan, Steven R.	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	32,000	Common	$ 0.6250	No	Carabi Partners AB	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	480,000	Common	$ 0.6250	No	Lee Roh Peng Rick and Koo Woan Ru Tiffany	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	40,000	Common	$ 0.6250	No	Corner8 Investments BV	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	32,000	Common	$ 0.6250	No	Cheryl Chia	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	1,600,000	Common	$ 0.6250	No	Nantahala Capital Management, LLC	Private Equity Raise	Yes	Reg D
1/12/2018	New issuance	80,000	Common	$ 0.6250	No	Kirt Gardner	Private Equity Raise	Yes	Reg D
3/10/2018	New issuance	1,249	Common	$ 0.7200	No	Blanchard, Jr., Edward Vermont	Director's RSU Vested	Yes	Rule 701
3/10/2018	New issuance	1,249	Common	$ 0.7200	No	Moorhead III, Rodman W.	Director's RSU Vested	Yes	Rule 701
3/10/2018	New issuance	1,249	Common	$ 0.7200	No	Moses, Michael A.	Director's RSU Vested	Yes	Rule 701
3/10/2018	New issuance	1,249	Common	$ 0.7200	No	Tallal, Paula A.	Director's RSU Vested	Yes	Rule 701
8/10/2018	Cancellation	274	Common	$ 0.1039	No	Jeanne Larue	Employee RSU Vested Adjustme	Yes	Rule 701
9/10/2018	New issuance	625	Common	$ 0.6750	No	Blanchard, Jr., Edward Vermont	Director's RSU Vested	Yes	Rule 701
9/10/2018	New issuance	625	Common	$ 0.6750	No	Moorhead III, Rodman W.	Director's RSU Vested	Yes	Rule 701
9/10/2018	New issuance	625	Common	$ 0.6750	No	Moses, Michael A.	Director's RSU Vested	Yes	Rule 701
9/10/2018	New issuance	625	Common	$ 0.6750	No	Tallal, Paula A.	Director's RSU Vested	Yes	Rule 701
Number of Shares outstanding as of December 31, 2018	**Ending Balance** Common:	**27,622,674**							
3/10/2019	New issuance	1,250	Common	$ 0.3799	No	Blanchard, Jr., Edward Vermont	Director's RSU Vested	Yes	Rule 701
3/10/2019	New issuance	1,250	Common	$ 0.3799	No	Moorhead III, Rodman W.	Director's RSU Vested	Yes	Rule 701
3/10/2019	New issuance	1,250	Common	$ 0.3799	No	Moses, Michael A.	Director's RSU Vested	Yes	Rule 701
3/10/2019	New issuance	1,250	Common	$ 0.3799	No	Tallal, Paula A.	Director's RSU Vested	Yes	Rule 701
4/1/2019	New issuance	116,806	Common	$ 0.3360	No	Cory Arms, Valerie Beattie, Martha Burns, Lan Dai, Kimberly Dill, Rhonda Flores, Stephen Gardner, Dimas Guardado, Katherine Hartman, Anthony Lopez, Hoa Lu, Wendy Mathieu, Scott McCale, Tracy McShan, Steven Nathan, Marc Vittoria, Iris Washburn and Leslie Wells	Employee's Stock Bonus vested	Yes	Rule 701
7/1/2019	New issuance	13,083	Common	$ 0.2459	No	Kimberly Dill, Hoa Lu and Marc Vittoria	Employee's Stock Bonus vested Adjustments	Yes	Rule 701
7/1/2019	New issuance	1,913	Common	$ 0.2459	No	Thomas, Jeffrey D.	Employee's RSU vested	Yes	Rule 701
9/10/2019	New issuance	624	Common	$ 0.1450	No	Blanchard, Jr., Edward Vermont	Director's RSU Vested	Yes	Rule 701
9/10/2019	New issuance	624	Common	$ 0.1450	No	Moorhead III, Rodman W.	Director's RSU Vested	Yes	Rule 701
9/10/2019	New issuance	624	Common	$ 0.1450	No	Moses, Michael A.	Director's RSU Vested	Yes	Rule 701
9/10/2019	New issuance	624	Common	$ 0.1450	No	Tallal, Paula A.	Director's RSU Vested	Yes	Rule 701
9/10/2019	New issuance	473	Common	$ 0.1450	No	Thomas, Jeffrey D.	Employee's RSU vested	Yes	Rule 701
10/1/2019	New issuance	7,228	Common	$ 0.1500	No	Kimberly Dill, Hoa Lu and Marc Vittoria	Employee's Stock Bonus vested Adjustments	Yes	Rule 701
Number of Shares outstanding as of December 31, 2019 *	**Ending Balance**								
	Common:	**27,769,673**							

*As of December 31, 2019, common stock warrants of 8,000,000 were also outstanding

B. Debt Securities, Including Promissory and Convertible Notes

Use the chart and additional space below to list and describe all outstanding promissory notes, convertible notes, convertible debentures, or any other debt instruments that may be converted into a class of the issuer's equity securities

Check this box if there are no outstanding promissory, convertible notes or debt arrangements: ☐

Date of Note Issuance	Outstanding Balance ($)	Principal Amount at Issuance ($)	Interest Accrued ($) as of Report Date	Maturity Date	Conversion Terms (e.g. pricing mechanism for determining conversion of instrument to shares)	Name of Noteholder (entities must have individual with voting / investment control disclosed)	Reason for Issuance (e.g. Loan, Services, etc.)
4/6/2015	$403,555.13	$403,555.13	$3,084.71	10/31/2022	Warrants issues along with debt	BLACKWELL PARTNERS LLC SERIES A (Dan Mack)	Loan
4/6/2015	$760,059.83	$760,059.83	$5,809.77	10/31/2022	Warrants issues along with debt	NANTAHALA CAPITAL PARTNERS II, LIMITED PARTNERSHIP (Dan Mack)	Loan
4/6/2015	$236,385.04	$236,385.04	$1,806.89	10/31/2022	Warrants issues along with debt	NANTAHALA CAPITAL PARTNERS, LIMITED PARTNERSHIP (Dan Mack)	Loan
4/6/2015	$216,300.00	$216,300.00	$1,653.36	10/31/2022	Warrants issues along with debt	TRIGRAN INVESTMENTS, LP (Larry Oberman)	Loan
4/6/2015	$133,700.00	$133,700.00	$1,021.98	10/31/2022	Warrants issues along with debt	TRIGRAN INVESTMENTS, LP II (Larry Oberman)	Loan
4/6/2015	$250,000.00	$250,000.00	$1,910.96	10/31/2022	Warrants issues along with debt	PAULA A. TALLAL, REVOCABLE TRUST (Paula A. Tallal)	Loan
4/6/2015	$250,000.00	$250,000.00	$1,910.96	10/31/2022	Warrants issues along with debt	RODMAN W. MOORHEAD III REVOCABLE TRUST (Rodman W. Moorhead III)	Loan
4/6/2015	$50,000.00	$50,000.00	$382.19	10/31/2022	Warrants issues along with debt	JANE A. FREEMAN LIVING TRUST (5/30/12) (Jane A. Freeman)	Loan
4/6/2015	$200,000.00	$200,000.00	$1,528.77	10/31/2022	Warrants issues along with debt	ROBERT BOWEN	Loan
4/6/2015	$2,500,000.00	$2,500,000.00	$19,109.59	10/31/2022	Warrants issues along with debt	TCG GROWTH AND INCOME FUND, LLC (Chris Jamail)	Loan
7/13/2017	$231,000.00	$231,000.00	$1,765.73	10/31/2022	Warrants issues along with debt	NANTAHALA CAPITAL PARTNERS, LIMITED PARTNERSHIP ("NOTE A") (Dan Mack)	Loan
7/13/2017	$769,000.00	$769,000.00	$5,878.11	10/31/2022	Warrants issues along with debt	BLACKWELL PARTNERS LLC SERIES A (NOTE "B") (Dan Mack)	Loan

Use the space below to provide any additional details, including footnotes to the table above:

See additional information in the Subordinated Debt footnote in the attached financial statements

4) Financial Statements

A. The following financial statements were prepared in accordance with:

☒ U.S. GAAP
☐ IFRS

See the attached financial statements above this disclosure.

B. The financial statements for this reporting period were prepared by (name of individual)[4]:

Name: Steve Nathan
Title: CFO
Relationship to Issuer: Officer

Financial statement information is considered current until the due date for the subsequent report (as set forth in the qualifications section above). To remain qualified for Current Information, a company must post its Annual Report within 90 days from its fiscal year-end date and Quarterly Reports within 45 days of each fiscal quarter-end date.

[4] The financial statements requested pursuant to this item must be prepared in accordance with US GAAP or IFRS by persons with sufficient financial skills.

5) Issuer's Business, Products and Services

The purpose of this section is to provide a clear description of the issuer's current operations. In answering this item, please include the following:

A. Summarize the issuer's business operations (If the issuer does not have current operations, state "no operations")

Scientific Learning is a SaaS education company. We differentiate ourselves along two dimensions, results and methodology. Most importantly, our products achieve significant and lasting gains for struggling readers. Proof that our products produce substantial academic gains has been demonstrated by over 250 efficacy studies, including randomized controlled trials and longitudinal studies. These studies show gains for students at all K-12 grade levels, for at-risk, special education, English language, Title I (low income, under achieving), and a variety of other students. Gains have been demonstrated throughout the United States and in several other countries. The studies show that these gains endure over time. We are able to achieve these unique gains because our methodology combines advances in the field of brain research with standards-based learning objectives.

We provide our learning solutions primarily to U.S. K-12 schools in traditional brick-and-mortar, virtual or blended learning settings and also to parents and learning centers, in approximately fifty-five countries around the world.

Our web-based platforms are able to effectively deliver individualized learning opportunities to a large number of students simultaneously. Our Fast ForWord and Reading Assistant educational software products are available on our browser-based on-demand platform MySciLEARN, which we host. The MySciLEARN platform meets the needs of institution and district-wide installations by providing scalability, remote access, centralized reporting, asynchronous online professional development, and ease of administration for multiple campuses.

B. Describe any subsidiaries, parents, or affiliated companies, if applicable, and a description of their business contact information for the business, officers, directors, managers or control persons. Subsidiary information may be included by reference

The Company had a wholly-owned subsidiary in Shanghai, China. This subsidiary was the Company's former development center and was discontinued in 2013 with no material activity subsequently. In July 2018, this subsidiary was deconsolidated from its U.S. parent.

C. Describe the issuers' principal products or services, and their markets

See Section 5A above

6) Issuer's Facilities

The goal of this section is to provide a potential investor with a clear understanding of all assets, properties or facilities owned, used or leased by the issuer. In responding to this item, please clearly describe the assets, properties or facilities of the issuer, give the location of the principal plants and other property of the issuer and describe the condition of the properties. If the issuer does not have complete ownership or control of the property (for example, if others also own the property or if there is a mortgage on the property), describe the limitations on the ownership.

If the issuer leases any assets, properties or facilities, clearly describe them as above and the terms of their leases.

We currently have the following leased properties:

1. A lease for approximately 7,200 square feet of office space in Oakland, California for our headquarters, which expires in March 2021.
2. A lease for approximately 10,800 square feet of office space in Tucson, Arizona for our sales and support center, which expires in August 2022.

7) Officers, Directors, and Control Persons

The goal of this section is to provide an investor with a clear understanding of the identity of all the persons or entities that are involved in managing, controlling or advising the operations, business development and disclosure of the issuer, as well as the identity of any significant or beneficial shareholders.

Using the tabular format below, please provide information regarding any person or entity owning 5% of more of the issuer, as well as any officer, and any director of the Company, regardless of the number of shares they own. **If any listed are corporate shareholders or entities, provide the name and address of the person(s) beneficially owning or controlling such corporate shareholders, or the name and contact information of an individual representing the corporation or entity in the note section**

Name of Officer/Director and Control Person	Affiliation with Company (e.g. Officer/Director/Owner of more than 5%)	Residential Address (City / State Only)	Number of shares owned	Share type/class	Ownership Percentage of Class Outstanding	Note
Robert Bowen	Chairman	Superstition Mountain, AZ	1,495,715	Common	5.39%	
E. Vermont Blanchard	Director	New York, NY	821,053	Common	2.96%	
Rodman Moorhead	Director	Wilson, WY	2,128,241	Common	7.66%	
Michael Moses	Director	Dallas, TX	122,575	Common	0.44%	
Dr. Paula Tallal	Director	San Diego, CA	728,024	Common	2.62%	
Jeffrey D. Thomas	CEO and Director	Spokane, WA	44,576	Common	0.16%	
Chris Brookhart	SVP General Counsel & Secretary	Highland, UT	15,000	Common	0.05%	
Steve Nathan	CFO & Treasurer	Franklin, TN	48,335	Common	0.17%	
Nantahala Capital Management, LLC and affiliates - Dan Mack	> 5% Owner	Darien, CT	9,855,714	Common	35.49%	
Osmium Partner - John Lewis	> 5% Owner	San Francisco, CA	1,499,812	Common	5.40%	

The above share information for >5% owners is based on shares self-reported to the company.

8) Legal/Disciplinary History

A. Please identify whether any of the persons listed above have, <u>in the past 10 years</u>, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

   <u>NONE</u>

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

   <u>NONE</u>

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

   <u>NONE</u>

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred, suspended, or otherwise limited such person's involvement in any type of business or securities activities.

   NONE

B. Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the issuer or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities.

   NONE

9) Third Party Providers

Please provide the name, address, telephone number and email address of each of the following outside providers:

Securities Counsel

Name: Steven Bernard
Firm: Wilson, Sonsini Goodrich & Rosati
Address 1: 650 Page Mill Road
Address 2: Palo Alto, CA 94304
Phone: 650.493.9300
Email: sbernard@wsgr.com

Accountant or Auditor

Name: Heather Moore
Firm: Armanino LLP
Address 1: 50 West San Fernando Street, Suite 500
Address 2: San Jose, CA 95113
Phone: 408-200-6400
Email: heather.moore@amllp.com

Investor Relations Consultant

Name: NONE

Other Service Providers

Provide the name of any other service provider(s), including, counsel, advisor(s) or consultant(s) **that assisted, advised, prepared or provided information with respect to this disclosure statement**, or provided assistance or services to the issuer during the reporting period.

Name: NONE

10) Issuer Certification

The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles but having the same responsibilities). The certifications shall follow the format below:

Principal Executive Officer:

I, Jeffrey D. Thomas certify that:

1. I have reviewed this annual disclosure statement of Scientific Learning Corp;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

April 14, 2020

/s/ Jeffrey D. Thomas, CEO and Director

Principal Financial Officer:

I, Steve Nathan certify that:

1. I have reviewed this annual disclosure statement of Scientific Learning Corp;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

April 14, 2020

/s/ Steve Nathan, CFO and Treasurer