

Democrasoft, Inc.
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT
December 31, 2011 and 2010



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Democrasoft, Inc.

We have audited the accompanying balance sheets of Democrasoft, Inc. (the "Company") as of December 31, 2011 and 2010, and the related statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

DZH Phillips LLP

San Francisco, California
September 19, 2012

Democrasoft, Inc.

BALANCE SHEETS

December 31, 2011 and 2010

ASSETS

	<u>2011</u>	<u>2010</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 272,617	\$ 396,067
Investments in Treasury notes	599,988	3,597,936
Prepaid expenses and advances	66,914	19,110
Total current assets	<u>939,519</u>	<u>4,013,113</u>
PROPERTY AND EQUIPMENT - net	<u>20,808</u>	<u>37,432</u>
OTHER ASSETS		
Deposits	<u>8,970</u>	<u>8,740</u>
	<u>\$ 969,297</u>	<u>\$ 4,059,285</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES		
Accrued expenses and accounts payable	\$ 175,076	\$ 67,774
COMMITMENTS	-	-
SHAREHOLDERS' EQUITY		
Convertible preferred stock, \$.00001 par value; 20,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$.00001 par value; 100,000,000 shares authorized; 43,550,480 and 42,500,480 shares issued and outstanding, respectively	437	426
Additional paid-in capital	67,622,437	67,398,137
Accumulated deficit	(65,982,437)	(62,576,596)
Shareholders' notes receivable, including accrued interest of \$185,424 and \$177,518, respectively	(847,214)	(839,308)
Accumulated other comprehensive income:		
Unrealized gain on marketable securities	998	8,852
Total shareholders' equity	<u>794,221</u>	<u>3,991,511</u>
	<u>\$ 969,297</u>	<u>\$ 4,059,285</u>

The accompanying notes are an integral part of these statements.

Democrasoft, Inc.

STATEMENTS OF OPERATIONS

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenues:		
Patent sales and settlements	\$ 1,010,000	\$ -
Software development and research fees	202,929	9,675
	<u>1,212,929</u>	<u>9,675</u>
Operating expenses:		
General and administrative	3,817,094	1,477,896
Research and development	751,685	1,974,455
Costs associated with licensing revenue	66,750	-
	<u>4,635,529</u>	<u>3,452,351</u>
Loss from operations	<u>(3,422,600)</u>	<u>(3,442,676)</u>
Other income (expenses):		
Interest income	8,021	23,623
Other income	-	104
Interest expense	-	(17,252)
Gain on sale of securities	11,964	17,777
Other taxes	(2,426)	(3,283)
Total other income - net	<u>17,559</u>	<u>20,969</u>
Loss before income taxes	(3,405,041)	(3,421,707)
Income taxes	<u>800</u>	<u>5,136</u>
NET LOSS	(3,405,841)	(3,426,843)
Unrealized loss	<u>(7,854)</u>	<u>(208)</u>
Total comprehensive loss	<u>\$ (3,413,695)</u>	<u>\$ (3,427,051)</u>
Net (loss) income per share - basic	<u>\$ (0.0793)</u>	<u>\$ (0.0807)</u>
Net (loss) income per share - diluted	<u>\$ (0.0793)</u>	<u>\$ (0.0803)</u>
Weighted average number of common shares outstanding	<u>43,550,480</u>	<u>42,500,480</u>

The accompanying notes are an integral part of these statements.

Democrasoft, Inc.

STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended December 31, 2011 and 2010

	Common Stock		Shareholders' Notes	Accumulated Other Comprehensive Income	Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount					
Balance - December 31, 2009	42,500,480	\$ 426	\$ (820,232)	\$ 9,060	\$ 67,382,442	\$ (59,149,753)	\$ 7,421,943
Stock option compensation expense	-	-	-	-	15,695	-	15,695
Net loss	-	-	-	-	-	(3,426,843)	(3,426,843)
Unrealized loss on securities	-	-	-	(208)	-	-	(208)
Payments received on notes receivable	-	-	4,500	-	-	-	4,500
Interest earned on notes receivable	-	-	(23,576)	-	-	-	(23,576)
Balance - December 31, 2010	42,500,480	426	(839,308)	8,852	67,398,137	(62,576,596)	3,991,511
Stock option compensation expense	-	-	-	-	26,111	-	26,111
Net loss	-	-	-	-	-	(3,405,841)	(3,405,841)
Sale of stock - \$.25 per share	100,000	1	-	-	24,999	-	25,000
Sale of stock - \$.027 per share	400,000	4	-	-	10,796	-	10,800
Sale of stock - \$.031 per share	400,000	4	-	-	12,396	-	12,400
Share-based compensation	150,000	2	-	-	149,998	-	150,000
Unrealized loss on securities	-	-	-	(7,854)	-	-	(7,854)
Interest earned on notes receivable	-	-	(7,906)	-	-	-	(7,906)
Balance - December 31, 2011	<u>43,550,480</u>	<u>\$ 437</u>	<u>\$ (847,214)</u>	<u>\$ 998</u>	<u>\$ 67,622,437</u>	<u>\$ (65,982,437)</u>	<u>\$ 794,221</u>

The accompanying notes are an integral parts of these statements.

Democrasoft, Inc.

STATEMENTS OF CASH FLOWS

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows provided by (used in) operating activities:		
Net loss	\$ (3,405,841)	\$ (3,426,843)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	15,874	10,192
Decrease in comprehensive income	(7,854)	(208)
Stock option compensation expense	26,111	15,695
Share-based compensation	150,000	-
Realized gain on securities	(11,964)	(17,777)
(Increase) decrease in assets:		
Prepaid expenses and advances	(47,804)	(16,162)
Income tax receivable, including interest receivable	-	898,213
Interest receivable on shareholders' notes	(7,906)	(23,576)
Deposits	(230)	-
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	107,302	(2,465)
State income taxes payable	-	(52,702)
Net cash used in operating activities	<u>(3,182,312)</u>	<u>(2,615,633)</u>
Cash flows provided by (used in) investing activities:		
Proceeds from sale of securities available-for-sale - net	3,009,912	2,862,138
Purchase of property and equipment	-	(47,624)
Proceeds from sale of property and equipment	750	-
Proceeds from note receivable - shareholder	-	10,759
Proceeds from notes receivable	-	4,500
Net cash provided by investing activities	<u>3,010,662</u>	<u>2,829,773</u>
Cash flows provided by (used in) financing activities:		
Proceeds from sale of common stock	<u>48,200</u>	<u>-</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(123,450)	214,140
Cash and cash equivalents - beginning of year	<u>396,067</u>	<u>181,927</u>
Cash and cash equivalents - end of year	<u>\$ 272,617</u>	<u>\$ 396,067</u>
Supplemental disclosures:		
Income tax refund received	\$ -	\$ 898,213
Income taxes paid	\$ -	\$ 74,000
Interest paid	\$ -	\$ 17,252

The accompanying notes are an integral part of these statements.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and capitalization

Democrasoft, Inc., a Delaware corporation (the “Company”), was incorporated in the State of Delaware as Instant Video Technologies, Inc. On January 27, 2000, the Certificate of Incorporation was amended to change the Company's name to Burst.com, Inc. On March 19, 2010, the certificate of incorporation was further amended to change the Company’s name to Democrasoft, Inc.

The Company's authorized capital stock consists of 100,000,000 shares of common stock, \$0.00001 par value per share, and 20,000,000 shares of preferred stock, \$0.00001 per share.

The board of directors has the authority, without action by the Company's shareholders, to provide for the issuance of preferred stock in one or more classes or series and to designate the rights, preferences and privileges of each class or series, which may be greater than the rights of the common stock. At December 31, 2011 and 2010, the Company had no preferred stock outstanding.

Business

The Company has built a robust cloud-based platform comprised of several key components that can be combined and expressed in a multitude of ways. These components can be simple and singular (a mobile app that lets the user create and share a WeJIT from his or her mobile device – see below) or comprehensive (a licensable platform slice that provides destination sites a way to share discussion topics (WeJITs) in an online library setting, mobile access or both). Applications expressed off the Collaborize platform can service education, innovation (the ability to operate as a “Challenge” engine for private and public enterprise), and as a “nomination” engine that uses a template-based form to quickly collect nominations from every participant, while automatically ranking them in order of popularity in real-time (this enables even large groups to nominate people, songs, movies, entries, recipes, almost anything). The Company's primary monetization strategy is the licensing of its WeJIT capabilities, its intellectual property, and the core functionality of its Collaborize platform (both within the education market and beyond).

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Liquidity and Going Concern

The accompanying financial statements have been prepared assuming the Company will continue as a going concern for a reasonable period of time. At December 31, 2011, the Company had cash and cash equivalents of \$872,605. In 2011, the Company has incurred significant losses due to research and development of its new online software product which has not yet begun to generate significant revenue. At December 31, 2011, the Company has an accumulated deficit of approximately \$65,982,000.

The Company's management has identified certain revenue growth opportunities for 2012 related to its software launch and is looking into possible financing resources to increase cash flow to continue the funding of the Company beyond 2012. During 2012, the Company obtained additional financing of \$770,000 from its existing investors in a form of bridge notes (refer to Note K). In addition, management has implemented significant cost cutting measures. Management expects that existing cash resources will be adequate to support the Company's operations through the year ending December 31, 2012, at a minimum.

Use of estimates

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and operations for the period. Although these estimates are based on management's knowledge of current events and actions it may undertake in the future, they may ultimately differ from actual results.

Cash and cash equivalents

Cash and cash equivalents consist of money market accounts and other short-term investments with an original maturity of three months or less.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents. Risks associated with cash and cash equivalents are mitigated by banking with creditworthy institutions. Such balances with any one institution may, at times, be in excess of federally insured amounts. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES (continued)

Investments

The Company's investments consisted of debt securities classified as available-for-sale. Accordingly, they were carried at fair value. Unrealized gains and losses for available-for-sale securities are excluded from earnings and reported, net of deferred income taxes, as other comprehensive income.

Comprehensive income

The Company reports comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosures of certain financial information that historically has not been recognized in the calculation of net income. For the years ended December 31, 2011 and 2010, the Company's comprehensive income consists of unrealized gains and losses on securities available for sale, net of the related estimated deferred income tax effect associated with those gains and losses.

Revenue recognition

Revenue from the sale of online subscriptions is generally recognized ratably over the subscription period. Revenue from the sale of patents is recognized when received. License fees are generally recognized as revenue ratably over the license period. Revenue from settlements is recognized when received. The revenue from settlements is reported gross of legal fees and costs.

Research and development costs

Research and development costs represent salaries, related benefits, costs, expenses incurred for the design and testing of new products and processing methods and other expenses related to the research development of new products. Research and development costs are expensed as incurred.

Property, equipment and depreciation

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets that range from three to five years. Replacements, maintenance and repairs, which do not extend the lives of the respective assets, are charged to expense as incurred.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES (continued)

Fair value of financial instruments

The Company's financial instruments consist primarily of cash and cash equivalents and available-for-sale securities. The carrying amounts of such financial instruments approximate their respective estimated fair value due to the short-term maturities and approximate market interest rates of these instruments.

Net (loss) income per common share and dilutive securities

Basic (loss) earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, if any, by the weighted-average number of shares of common stock outstanding during each period. Diluted (loss) earnings per share is computed by dividing net income by the weighted-average number of shares of common stock, common stock equivalents, and other potentially dilutive securities outstanding during the period.

Income taxes

The Company recognizes deferred tax assets and liabilities for future tax consequences of events that have been previously recognized in the Company's financial statements or tax returns. The primary differences relate to deductible temporary differences and depreciable assets. Deferred tax assets are recognized for deductible temporary differences, with a valuation allowance established against the resulting assets to the extent it is more likely than not that the related tax benefit will not be realized. The measurement of deferred tax assets and liabilities is based on provisions on the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. At December 31, 2011 and 2010, a full valuation allowance was established against the deferred tax assets.

Each year, management considers whether any material tax position the Company has taken is more likely than not to be sustained upon examination by the applicable taxing authority. Management believes that any positions the Company has taken are supported by substantial authority and, hence, do not need to be measured or disclosed in the attached financial statements. Tax returns for years subsequent to December 31, 2008, are subject to examination by federal and state tax authorities.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Advertising costs

Advertising costs are expensed as incurred. For the year ended December 31, 2011, advertising costs were \$117,998. For the year ended December 31, 2010, there were no advertising costs.

Patent expenses

The Company charges the costs of internally-developing patents to expense as they are incurred.

Stock-based compensation

All share-based payments to employees (or to non-employee directors as compensation for service on the Board of Directors) are recognized as compensation expense in the financial statements, based on the fair values of such payments.

The Company estimates the value of the options granted to employees using the Black-Scholes model. The expected term represents the period of time that options granted are expected to be outstanding, which is usually the time until the option expires. The risk-free interest rate for each option is based on the Treasury bill yield in effect at the date of each grant assuming the expected term to maturity.

The terms of the awards include service, market and performance conditions. Compensation cost is recognized only if the performance and service conditions are satisfied. Market conditions are reflected in the fair value of the stock options.

Stock-based compensation arrangements to nonemployees are accounted for using a fair value approach. The compensation costs of these arrangements are booked as consulting expense. Awards granted to directors elected by employer's shareholders for their services as directors will be treated as awards to employees. Awards granted to directors for other services are accounted for as awards to nonemployees.

Subsequent events

Management has evaluated events and transactions for potential recognition or disclosure through September 19, 2012, which represents the date the financial statements were available to be issued.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE B - INVESTMENTS IN SECURITIES AVAILABLE-FOR-SALE

Investments consist exclusively of US Treasury notes. At December 31, 2011 and 2010, the aggregate market value of investments exceeded their aggregate cost by \$998 and \$8,852, respectively.

At December 31, 2011, investments consisted of the US Treasury note, due within one year, with fair value and cost, as follows:

	<u>2011</u>	<u>2010</u>
Fair market value	\$ 599,988	\$ 3,597,936
Cost	<u>598,990</u>	<u>3,589,084</u>
Unrealized gain	<u>\$ 998</u>	<u>\$ 8,852</u>

NOTE C - FAIR VALUE MEASUREMENTS

At December 31, 2011 and 2010, the Company's assets at fair value set forth by level, within the fair value hierarchy, were as follows:

	<u>2011</u>	<u>2010</u>
U.S. government securities, Level 1	<u>\$ 599,988</u>	<u>\$ 3,597,936</u>

U.S. government securities are valued at the closing price reported on the active market on which the individual securities are traded.

The three-level hierarchy for fair value measurement is defined as follows:

Level 1 - Inputs to the valuation methodology are quoted prices in active markets for identical assets that the Plan has the ability to access at the measurement date.

Level 2 - Inputs to the valuation methodology are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly. Fair value can be determined through the use of models or other valuation methodologies.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE C - FAIR VALUE MEASUREMENTS (continued)

Level 3 - Inputs to the valuation methodology are unobservable inputs for the asset. Unobservable inputs are those that reflect the Plan's own assumptions about the assumptions that market participants would use in pricing the asset developed, based on the best information available.

For the years ended December 31, 2011 and 2010, there were no Level 2 or 3 investments.

NOTE D - PROPERTY AND EQUIPMENT

At December 31, 2011 and 2010, property and equipment consisted of the following:

	<u>2011</u>	<u>2010</u>
Computer equipment	\$ 82,940	\$ 83,690
Furniture	44,094	44,094
Office equipment	11,121	11,121
Software	55,644	55,644
Trade show booth	<u>5,000</u>	<u>5,000</u>
	198,799	199,549
Less: accumulated depreciation	<u>(177,991)</u>	<u>(162,117)</u>
	<u>\$ 20,808</u>	<u>\$ 37,432</u>

For the years ended December 31, 2011 and 2010, depreciation expense was \$15,874 and \$10,192, respectively.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE E - NOTES RECEIVABLE - SHAREHOLDERS

Stock subscriptions receivable that resulted from stock option exercises are reported as a deduction from shareholders' equity. At December 31, 2011 and 2010, notes receivable-shareholders consisted of the following:

	<u>2011</u>	<u>2010</u>
Note receivable from employee bears interest at .43% and 3.65% per annum for 2011 and 2010, respectively; secured by 500,000 shares of stock in the Company; due September 20, 2014.	\$ 376,982	\$ 376,982
Note receivable from employee bears interest at .43% and 3.65% per annum for 2011 and 2010, respectively; secured by 156,975 shares of stock in the Company; due September 20, 2014.	112,558	112,558
Note receivable from employee bears interest at 3.58% per annum; secured by 1,400,000 shares of company stock; due December 28, 2016.	78,400	78,400
Note receivable from director bears interest at 3.58% per annum; secured by 400,000 shares of company stock; due December 28, 2016.	22,400	22,400
Note receivable from director bears interest at 3.58% per annum; secured by 400,000 shares of company stock; due December 28, 2016.	22,400	22,400
Note receivable from director bears interest at 3.58% per annum; secured by 400,000 shares of company stock; due December 28, 2016.	22,400	22,400
Note receivable from employee bears interest at 3.58% per annum; secured by 50,000 shares of company stock; due December 28, 2016.	2,800	2,800

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE E - NOTES RECEIVABLE - SHAREHOLDERS (continued)

	<u>2011</u>	<u>2010</u>
Note receivable from employee bears interest at 2.05% per annum; secured by 2,000,000 shares of company stock; due March 11, 2018.	18,000	18,000
Note receivable from employee bears interest at 2.05% per annum; secured by 300,000 shares of company stock; due March 11, 2018.	2,700	2,700
Note receivable from director bears interest at 2.05% per annum; secured by 250,000 shares of company stock; due March 11, 2018.	2,250	2,250
Note receivable from employee bears interest at 2.05% per annum; secured by 100,000 shares of company stock; due March 11, 2018.	<u>900</u>	<u>900</u>
	661,790	661,790
Accrued interest on notes receivable	<u>185,424</u>	<u>177,518</u>
	<u>\$ 847,214</u>	<u>\$ 839,308</u>

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE F - STOCK OPTIONS

On April 11, 2009, the Company adopted the 2009 Nonqualified Stock Option Plan (the "Plan"). The number of shares that may be subject to options under the Plan and sold under the Plan is 4,000,000 shares of common stock of the Company. The options are not transferrable and can only be exercised by the optionee. The options expire in 10 years. The grant of the options under the Plan is discretionary and can be authorized individually by the Board of Directors. The Company's stock options contain performance conditions, service conditions or both.

At December 31, 2011 and 2010, management determined that performance conditions were not probable for most stock option awards, except for 12 awards where performance conditions occurred before December 31, 2011 and 2010, and the options vested. For the year ended December 31, 2010, there were 4 awards with no performance conditions, where service conditions occurred and the options vested. Consequently, for the years ended December 31, 2011 and 2010, the Company has recorded stock options compensation expense for stock options vested in the amount of \$26,111 and \$15,695, respectively. The values of the stock option awards range from \$0.100 to \$0.306, depending on the grant date and the expected term, with the weighted average fair value of \$0.002 and \$0.014 for 2011 and 2010, respectively.

At December 31, 2011, unrecognized compensation expense for the options granted was \$264,856.

The assumptions used in the calculation of the fair value of the options granted in 2011 and 2010, using the Black-Scholes model, were as follows:

Weighted average exercise price	\$0.25
Weighted average expected term (in years)	1-5
Expected volatility	152%-167%
Weighted average risk-free interest rate	0.9%-2.6%

For the years ended December 31, 2011 and 2010, there were no warrants granted.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE F - STOCK OPTIONS (continued)

The following is a summary of all options and warrants activity for the years ended December 31, 2011 and 2010:

	<u>Options Outstanding</u>		<u>Warrants Outstanding</u>	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Balance, December 31, 2009	4,031,450	\$ 0.25	645,334	\$ 1.56
Options/warrants granted	335,000	\$ 0.25	-	
Options/warrants expired	<u>(382,450)</u>	\$ 0.25	<u>(12,000)</u>	\$ 1.50
Balance, December 31, 2010	3,984,000	\$ 0.25	633,334	\$ 1.56
Options/warrants granted	46,000	\$ 0.25	-	
Options/warrants expired	<u>(463,000)</u>	\$ 0.25	<u>(33,334)</u>	
Balance, December 31, 2011	<u>3,567,000</u>	\$ 0.25	<u>600,000</u>	\$ 1.56

At December 31, 2011, stock options exercisable were as follows:

Exercise Price Per Share	<u>Options Outstanding</u>			<u>Options Exercisable</u>		
	Options Granted	Number Outstanding	Weighted Average Exercise Price	Contractual Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$0.25	4,185,450	3,236,000	\$ 0.25	2.50	541,800	\$ 0.25
\$0.29	10,000	10,000	\$ 0.29	3.50	10,000	\$ 0.29
\$0.25	325,000	275,000	\$ 0.25	3.50	78,000	\$ 0.25
\$0.25	46,000	46,000	\$ 0.25	4.50	10,000	\$ 0.25
	<u>4,566,450</u>	<u>3,567,000</u>	\$ 0.25	2.55	<u>639,800</u>	\$ 0.25

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE F - STOCK OPTIONS (continued)

At December 31, 2011, warrants exercisable were as follows:

Exercise Price per Share	Warrants Outstanding			Warrants Exercisable		
	Warrants Granted	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$1.56	<u>600,000</u>	<u>600,000</u>	\$ 1.56	0.39	<u>600,000</u>	\$ 1.56

NOTE G - LEASE COMMITMENTS

The Company leases office space and equipment under various operating leases expiring at various times through 2014. The leases generally provide that the Company pay for insurance, taxes, and maintenance. On November 15, 2009, the Company executed an office lease, which provides for a 36-month term, effective February 1, 2010, and expires on February 1, 2013. During 2010, the Company amended the lease to expand their office space. Under the terms of the lease agreement, the Company has an option of terminating the lease after the first year with 120 days notice.

Future minimum rental payments of these leases are as follows:

<u>Year ending December 31,</u>	
2012	\$ 100,548
2013	10,876
2014	<u>2,724</u>
	<u>\$ 114,148</u>

For the years ended December 31, 2011 and 2010, rent expense was \$102,495 and \$71,786, respectively.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE H - INCOME TAXES

For the years ended December 31, 2011 and 2010, income taxes was as follows:

	<u>2011</u>	<u>2010</u>
State:		
Current	\$ 800	\$ 5,136
Deferred	-	-
	<u>\$ 800</u>	<u>\$ 5,136</u>

At December 31, 2011 and 2010, the Company had net operating loss carry-forwards for federal income tax purposes of approximately \$19,482,000 and \$15,300,000, respectively, subject to annual limitations, and are available to offset future taxable income, if any, through 2031.

At December 31, 2011 and 2010, the Company had a net operating loss carry-forward for state income tax purposes of approximately \$7,707,000 and \$3,200,000, respectively, subject to annual limitations, and is available to offset future taxable income, if any, through 2031.

At December 31, 2011 and 2010, deferred tax assets were comprised of the following:

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Net operating losses	\$ 7,305,000	\$ 5,483,641
Research and experimentation credit	439,656	463,841
State income tax effect	272	272
Stock option compensation expense	-	9,007
Alternative minimum tax credit	82,682	79,079
Other	<u>7,536</u>	<u>2,066</u>
Total deferred tax assets	7,835,146	6,037,906
Less: valuation allowance	<u>(7,835,146)</u>	<u>(6,037,906)</u>
	<u>\$ -</u>	<u>\$ -</u>

The effective income tax rate is lower than expected when the federal and state statutory tax rates are applied to the loss before income taxes. The difference in the tax rates results primarily from a full valuation allowance applied against the deferred tax asset.

Democrasoft, Inc.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2011 and 2010

NOTE I - BUSINESS RISKS

The Company had no material revenue in 2011 and 2010 from its software development and research fees. The Company's anticipated sources of revenue include the monetization of the educational application of its platform, proceeds from sale or licensing of the other applications built on the core platform, and proceeds from the sale of non-core intellectual property. The Company's future operating results will depend on its ability to monetize its technology.

NOTE J - RECLASSIFICATIONS

Certain prior period amounts have been reclassified to conform to the current year presentations.

NOTE K - SUBSEQUENT EVENTS

During 2012, the Company obtained additional financing of \$770,000 from its existing stockholders in a form of bridge notes. The notes are due in September 2014, bear interest at 10% per annum, are secured by the Company's intellectual property, and are convertible into the Company's common stock at \$0.08 per share.