



**FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
TOGETHER WITH
INDEPENDENT AUDITOR'S REPORT**

EARTHWATCH INSTITUTE, INC.

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SEPTEMBER 30, 2012 AND 2011**

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying statements of financial position of Earthwatch Institute, Inc. (a Massachusetts corporation, not for profit) as of September 30, 2012 and 2011, and the related statements of activities, changes in net assets, cash flows and functional expenses for the years then ended. These financial statements are the responsibility of Earthwatch's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Earthwatch Institute, Inc. as of September 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.


Wellesley, Massachusetts
March 14, 2013

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2012 AND 2011

ASSETS	2012			2011				
	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
CURRENT ASSETS:								
Cash and cash equivalents	\$ -	\$ 224,443	\$ -	\$ 224,443	\$ -	\$ 739,653	\$ -	\$ 739,653
Investments	-	715,165	-	715,165	-	620,559	-	620,559
Current portion of grants and pledges receivable	88,000	1,356,639	150,000	1,594,639	-	1,665,415	200,000	1,865,415
Prepaid field grant expense, net	32,858	-	-	32,858	44,676	-	-	44,676
Prepaid expenses	61,590	-	-	61,590	104,838	-	-	104,838
Due from affiliates, net	120,207	-	-	120,207	179,688	-	-	179,688
Due (to) from	(158,565)	200,864	(42,299)	-	(821,587)	859,728	(38,141)	-
Total current assets	144,090	2,497,111	107,701	2,748,902	(492,385)	3,885,355	161,859	3,554,829
INVESTMENTS								
	-	157,442	1,306,736	1,464,178	-	-	1,084,443	1,084,443
GRANTS AND PLEDGES RECEIVABLE, net								
of current portion and discount	-	916,431	148,025	1,064,456	-	1,107,577	295,074	1,402,651
PROPERTY AND EQUIPMENT, net of accumulated depreciation								
	68,658	-	-	68,658	111,302	-	-	111,302
OTHER ASSETS:								
Interest in insurance policy contracts	423,759	-	-	423,759	419,115	-	-	419,115
Lease deposit	25,000	-	-	25,000	25,000	-	-	25,000
Intangible assets	66,895	-	-	66,895	66,895	-	-	66,895
Total assets	\$ 728,402	\$ 3,570,984	\$ 1,562,462	\$ 5,861,848	\$ 129,927	\$ 4,992,932	\$ 1,541,376	\$ 6,664,235
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES:								
Accounts payable and accrued expenses	\$ 563,853	-	\$ -	\$ 563,853	\$ 536,647	\$ -	\$ -	\$ 536,647
Deferred expedition income	682,620	-	-	682,620	958,511	-	-	958,511
Total current liabilities	1,246,473	-	-	1,246,473	1,495,158	-	-	1,495,158
ACCRUED RENT								
Total liabilities	53,378	-	-	53,378	42,005	-	-	42,005
	1,299,851	-	-	1,299,851	1,537,163	-	-	1,537,163
NET ASSETS:								
Unrestricted:								
Property and equipment and intangibles	135,553	-	-	135,553	178,197	-	-	178,197
Operating	(707,002)	-	-	(707,002)	(1,575,135)	-	-	(1,575,135)
Depreciation on permanently restricted endowment	-	-	-	-	(10,298)	-	-	(10,298)
Total unrestricted	(571,449)	-	-	(571,449)	(1,407,236)	-	-	(1,407,236)
Temporarily restricted	-	3,570,984	-	3,570,984	-	4,992,932	-	4,992,932
Permanently restricted	-	-	1,562,462	1,562,462	-	-	1,541,376	1,541,376
Total net assets	(571,449)	3,570,984	1,562,462	4,561,997	(1,407,236)	4,992,932	1,541,376	5,127,072
Total liabilities and net assets	\$ 728,402	\$ 3,570,984	\$ 1,562,462	\$ 5,861,848	\$ 129,927	\$ 4,992,932	\$ 1,541,376	\$ 6,664,235

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012			2011				
	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE AND SUPPORT:								
Gifts and grants	\$ 670,536	\$ 3,917,122	\$ -	\$ 4,587,658	\$ 1,004,169	\$ 4,724,635	\$ -	\$ 5,728,804
Contributions from domestic volunteers	3,191,367	-	-	3,191,367	2,690,280	-	-	2,690,280
Contributions from overseas volunteers	605,365	-	-	605,365	760,489	-	-	760,489
Investment income	19,952	-	-	19,952	25,337	-	-	25,337
Other	6,751	-	-	6,751	38,076	-	-	38,076
Investment earnings - endowment appropriation for operations	-	-	-	-	9,790	-	-	9,790
Net assets released from purpose restrictions	5,245,243	(5,245,243)	-	-	5,507,984	(5,507,984)	-	-
Net assets released from time restrictions	123,500	(123,500)	-	-	104,756	(104,756)	-	-
Total revenue and support	9,862,714	(1,451,621)	-	8,411,093	10,140,881	(888,105)	-	9,252,776
EXPENSES:								
Program	7,371,358	-	-	7,371,358	8,403,333	-	-	8,403,333
General and Administration	1,325,872	-	-	1,325,872	1,068,107	-	-	1,068,107
Fundraising	402,230	-	-	402,230	543,990	-	-	543,990
Total expenses	9,099,460	-	-	9,099,460	10,015,430	-	-	10,015,430
Changes in net assets from operations	763,254	(1,451,621)	-	(688,367)	125,451	(888,105)	-	(762,654)
NON-OPERATING REVENUES (EXPENSES):								
Investment gains (losses)	72,533	130,797	21,086	224,416	(105,545)	(53,282)	(11,053)	(169,880)
Investment income - endowment	-	26,645	-	26,645	-	44,729	-	44,729
Cancellation of grant	-	(127,769)	-	(127,769)	-	-	-	-
Endowment contributions	-	-	-	-	-	-	495,074	495,074
Investment earnings - endowment appropriation for operations	-	-	-	-	-	(9,790)	-	(9,790)
Total non-operating revenues (expenses)	72,533	29,673	21,086	123,292	(105,545)	(18,343)	484,021	360,133
Changes in net assets	\$ 835,787	\$ (1,421,948)	\$ 21,086	\$ (565,075)	\$ 19,906	\$ (906,448)	\$ 484,021	\$ (402,521)

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

**STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
NET ASSETS, September 30, 2010	\$ (1,427,142)	\$ 5,899,380	\$ 1,057,355	\$ 5,529,593
Changes in net assets	<u>19,906</u>	<u>(906,448)</u>	<u>484,021</u>	<u>(402,521)</u>
NET ASSETS, September 30, 2011	(1,407,236)	4,992,932	1,541,376	5,127,072
Changes in net assets	<u>835,787</u>	<u>(1,421,948)</u>	<u>21,086</u>	<u>(565,075)</u>
NET ASSETS, September 30, 2012	<u>\$ (571,449)</u>	<u>\$ 3,570,984</u>	<u>\$ 1,562,462</u>	<u>\$ 4,561,997</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets from operations	\$ (688,367)	\$ (762,654)
Adjustments to reconcile changes in net assets from operations to net cash provided by (used in) operating activities:		
Depreciation	59,539	87,347
Change in discount on grants and pledges receivable	(11,805)	13,388
Investment earnings - endowment appropriation for operations	-	(9,790)
Changes in operating assets and liabilities:		
Grants and pledges receivable	493,007	926,700
Prepaid field grant expense, net	11,818	14,677
Prepaid expenses	43,248	(37,733)
Due from affiliates, net	59,481	(76,888)
Accounts payable and accrued expenses	27,206	43,912
Deferred expedition income	(275,891)	124,065
Accrued rent	11,373	27,005
	<u>(270,391)</u>	<u>350,029</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(16,895)	(29,883)
Interest in insurance policy contracts	(4,644)	(4)
Purchase of investments	(1,329,891)	(885,391)
Proceeds from sale of investments	1,079,966	807,415
Investment income - endowment	26,645	44,729
	<u>(244,819)</u>	<u>(63,134)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(515,210)	286,895
CASH AND CASH EQUIVALENTS, beginning of year	739,653	452,758
CASH AND CASH EQUIVALENTS, end of year	\$ 224,443	\$ 739,653
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	<u>\$ 10,237</u>	<u>\$ 2,144</u>
Cost basis of donated stock	<u>\$ 113,678</u>	<u>\$ 104,261</u>
Cancellation of grant	<u>\$ 127,769</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.

STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012			2011			
	PROGRAM	GENERAL AND ADMINISTRATION	FUND-RAISING	TOTAL EXPENSES	GENERAL AND ADMINISTRATION	FUND-RAISING	TOTAL EXPENSES
SALARY AND RELATED:							
Salaries	\$ 2,185,975	\$ 707,364	\$ 171,599	\$ 3,064,938	\$ 526,102	\$ 329,314	\$ 3,386,643
Payroll taxes	210,504	60,127	65,632	336,263	31,661	31,081	278,379
Fringe benefits	113,111	70,995	46,376	230,482	60,436	20,123	250,981
Total salary and related	<u>2,509,590</u>	<u>838,486</u>	<u>283,607</u>	<u>3,631,683</u>	<u>618,199</u>	<u>380,518</u>	<u>3,916,003</u>
FIELD GRANTS	2,689,891	-	-	2,689,891	-	-	2,208,812
OTHER:							
Consultants and temporary help	633,404	140,443	16,571	790,418	31,020	23,055	1,305,085
Program expenses	500,594	12,172	468	513,234	4,397	449	577,227
Rent	207,902	54,494	20,364	282,760	158,592	2,797	314,730
Travel, staff development, seminars and conferences	199,264	40,176	22,519	261,959	9,552	53,915	602,245
Printing and postage	161,745	23,584	20,650	205,979	11,305	53,195	273,822
Meals and lodging	105,578	36,248	22,057	163,883	-	25,471	126,102
Insurance	121,750	10,530	3,935	136,215	14,781	-	125,473
Bank fees and merchant fees	71,439	32,472	-	103,911	12,939	-	96,935
Legal and accounting	9,894	71,719	-	81,613	38,279	-	93,414
Telephone	52,886	13,599	5,082	71,567	40,547	-	86,823
Depreciation	42,685	12,269	4,585	59,539	52,408	-	87,347
Information technology	-	21,372	-	21,372	17,149	593	30,593
Advertising	18,603	2,715	-	21,318	1,708	2,107	44,073
Miscellaneous	19,070	-	-	19,070	1,299	709	4,299
Facilities	12,874	3,701	1,383	17,958	46,654	-	78,111
Program equipment grants	10,314	-	-	10,314	-	-	25,683
Interest	-	10,237	-	10,237	1,286	-	2,144
Dues and subscriptions	3,875	566	1,009	5,450	2,363	1,181	6,479
Building repairs and maintenance	-	1,089	-	1,089	5,629	-	10,030
Total other	<u>2,171,877</u>	<u>487,386</u>	<u>118,623</u>	<u>2,777,886</u>	<u>449,908</u>	<u>163,472</u>	<u>3,890,615</u>
Total expenses	\$ 7,371,358	\$ 1,325,872	\$ 402,230	\$ 9,099,460	\$ 1,068,107	\$ 543,990	\$ 10,015,430

The accompanying notes are an integral part of these statements.

EARTHWATCH INSTITUTE, INC.
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011

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

OPERATIONS AND NONPROFIT STATUS

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

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

SIGNIFICANT ACCOUNTING POLICIES

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

Revenue Recognition

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

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

Net Assets

Earthwatch's net assets include the following:

- **Unrestricted:**

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

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

EARTHWATCH INSTITUTE, INC.
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
(Continued)

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Assets (Continued)

- **Unrestricted:** (Continued)

Depreciation on permanently restricted endowment represents the cumulative depreciation of those funds invested as permanently restricted endowment (see permanently restricted net assets). Losses on investments of a donor restricted endowment reduce temporarily restricted net assets to the extent of net accumulated appreciation on these funds. Any remaining loss reduces unrestricted net assets. Future gains, if any, that restore the assets of the endowment fund to the original level, will increase unrestricted net assets. As of September 30, 2011, there was \$10,298 of accumulated depreciation on permanently restricted endowment funds. In fiscal year 2012, investment gains restored the accumulated depreciation and, accordingly, there was no accumulated depreciation.

- **Temporarily restricted** represents grants and contributions whose uses have been limited by donors to a specific time period or purpose, including for underwriting field research for teachers and students and special projects. Earthwatch utilized \$200,864 and \$859,728 of temporarily restricted net assets as of September 30, 2012 and 2011, respectively, for operating cash flow. Management believes there will be sufficient cash flow, as well as amounts available on the line of credit (see Note 5), to meet all obligations as they become due. These amounts are reflected as due (to) from in the accompanying statements of financial position. Temporarily restricted net assets also include appreciation on unspent earnings on permanently restricted endowment.

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

	<u>2012</u>	<u>2011</u>
Purpose restricted	\$3,140,542	\$4,684,432
Time restricted	273,000	308,500
Appreciation and unspent earnings on permanently restricted endowment	157,442	-
	<u>\$3,570,984</u>	<u>\$4,992,932</u>

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

EARTHWATCH INSTITUTE, INC.
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
(Continued)

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Expense Allocations

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

Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Property, Equipment and Depreciation

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

Software, equipment and other	3 - 7 years
Leasehold improvements	5 years

Property and equipment consist of the following at September 30:

	<u>2012</u>	<u>2011</u>
Software	\$1,052,322	\$1,052,322
Office equipment	290,024	290,024
Data processing equipment	394,678	377,783
Other	99,157	99,157
Leasehold improvements	<u>31,924</u>	<u>31,924</u>
	1,868,105	1,851,210
Less – accumulated depreciation	<u>1,799,447</u>	<u>1,739,908</u>
	<u>\$ 68,658</u>	<u>\$ 111,302</u>

Cash and Cash Equivalents

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

EARTHWATCH INSTITUTE, INC.
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
(Continued)

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prepaid Field Grants

Prepaid field grants represent advances to researchers who generally field expeditions within two months of receipt of the advance. Accrued field grants (\$24,551 and \$4,052 at September 30, 2012 and 2011, respectively) represent amounts due to researchers upon completion of a project and their filing specific reports. These amounts, which are netted with prepaid field grants, are forfeited by the researcher if the reports are not submitted to Earthwatch by the date that is outlined in the contract. Field grant expenses are recognized when the expeditions are fielded.

Advertising Costs

Earthwatch expenses advertising costs as they are incurred.

Bequests

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

Deferred Expedition Income

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

Fair Value Measurements

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

Investment Return Allocations

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

EARTHWATCH INSTITUTE, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
(Continued)

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

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Return Allocations (Continued)

The Board of Directors of Earthwatch adopted a policy allowing for the use of a portion of total investment return on permanently restricted investments for operations each year. Annually, Earthwatch may appropriate for operations up to 5% of the average market values of its permanently restricted investment portfolio over the previous three years, measured at the end of the third quarter of the fiscal year. Under Earthwatch's policy, in no event shall such distribution reduce the value of the permanently restricted endowment portfolio below the historical dollar value at the time of the distribution. The amounts appropriated under this policy were \$9,790 for the year ended September 30, 2011. There were no appropriations for the year ended September 30, 2012 (see Note 4).

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

Accounting for Uncertainty in Income Taxes

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

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

Subsequent Events

Subsequent events have been evaluated through March 14, 2013, which is the date the financial statements were available to be issued. There were no events that met the criteria for recognition or disclosure in the financial statements.

(2) **RELATED PARTY TRANSACTIONS**

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

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011**

(Continued)

(2) RELATED PARTY TRANSACTIONS (Continued)

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

The following are the amounts due from and revenue derived from affiliates as of and for the years ended September 30:

	<u>2012</u>	<u>2011</u>
Amounts due from, net:		
Earthwatch Europe	\$ 66,900	\$121,032
Earthwatch Australia	45,373	25,012
Earthwatch Japan	<u>7,934</u>	<u>33,644</u>
	<u>\$120,207</u>	<u>\$179,688</u>
Revenue derived from:		
Earthwatch Europe	\$443,334	\$659,685
Earthwatch Australia	135,864	58,294
Earthwatch Japan	<u>26,167</u>	<u>42,510</u>
	<u>\$605,365</u>	<u>\$760,489</u>

Such revenue is reflected as contributions from overseas volunteers in the accompanying statements of activities.

During fiscal year 2007, Earthwatch received a grant of approximately \$10,166,000 from Earthwatch Europe, as part of a grant to Earthwatch Europe from HSBC Holdings PLC (HSBC). Earthwatch is participating, as a sub-grantee, in this climate change field research project. Earthwatch is carrying out portions of the project in North, South and Central America over six years. Earthwatch received approximately \$10,166,000 and \$9,508,000 through September 30, 2012 and 2011, respectively. The balance of this grant at September 30, 2011, was \$658,338, net of discount, which is included in the 2011 grants and pledges receivable (see Note 9). There was no balance outstanding as of September 30, 2012.

During fiscal year 2012, Earthwatch received a grant of approximately \$1,261,000 from Earthwatch Europe, as part of a grant to Earthwatch Europe from HSBC. Earthwatch is participating as a sub grantee, in this global water quality research project. Earthwatch will be carrying out portions of the project in North and Latin America over five years. Earthwatch has received \$524,701 as of September 30, 2012. The balance of this grant at September 30, 2012, was \$736,438 and is included in grants and pledges receivable (see Note 9). Earthwatch expects to collect this amount in fiscal year 2013.

During fiscal year 2012, Earthwatch also has other one-year grants with Earthwatch Europe with funding from HSBC. The funding totaled \$201,018 for fiscal year 2012.

EARTHWATCH INSTITUTE, INC.
NOTES TO FINANCIAL STATEMENTS
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(2) **RELATED PARTY TRANSACTIONS** (Continued)

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

	<u>2012</u>	<u>2011</u>
HSBC Water Project	\$ 985,408	\$ -
HSBC Climate Project	73,203	2,219,376
Other HSBC Projects	<u>63,764</u>	<u>-</u>
	<u>\$1,122,375</u>	<u>\$2,219,376</u>

On October 6, 2008, Earthwatch and Earthwatch Europe organized and incorporated Earthwatch International, Inc. (Earthwatch International) (a Delaware corporation, not for profit under IRC Section 501(c)(4)). Earthwatch International has no assets and had no activity as of and for the years ended September 30, 2012 and 2011. The Board of Directors of Earthwatch International consists of the Board members of each of the incorporators, with each incorporator having equal voting power. Earthwatch International's purpose is to provide internationally coordinated governance and administration for the benefit of organizations throughout the world that use Earthwatch trademarks and brand. Each party maintains its own independent governance and financial integrity. Certain costs, key executives and program and administrative staff serve both Earthwatch and Earthwatch Europe and costs are shared under a memorandum of agreement between the organizations.

Earthwatch participates in a Split Dollar and Collateral Assignment Agreement with Earthwatch's Founding Chairman and Board member (non-voting) who is the owner of the policies. From November 1998 through December, 2010, Earthwatch made annual premium payments totaling \$480,035. These policies are subject to termination upon certain defined circumstances. In the event of the split dollar policy cancellation, Earthwatch will receive an amount equal to the cash surrender value of the policy or the amount of premiums paid to date, whichever is less. In the event of death, Earthwatch will receive the cumulative amount of premium payments from the proceeds of the death benefit. The cash surrender values of the insurance policy contracts at September 30, 2012 and 2011, were \$423,759 and \$419,115, respectively. These amounts are reflected as interest in insurance policy contracts on the accompanying statements of financial position.

During fiscal year 2009, Earthwatch received a grant to fund a two-year agreement with the Founding Chairman and Board member to continue expanding development services, including evaluating new facility options and locations. The grant is receivable over two-years at \$150,000 per year. Earthwatch received \$150,000 during fiscal years 2009 and 2011. Amount expensed to the Founding Chairman under this grant was \$129,909 for the year ended September 30, 2011. The grant ended in fiscal year 2011 and there was no new grant made in fiscal year 2012.

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(Continued)

(3) INVESTMENTS

Investment income consists of interest and dividends. Interest income is recorded as earned and dividend income is recorded on the ex-dividend date. These investments are not insured and are subject to ongoing market fluctuations. All investments are valued using Level 1 inputs (see Note 1) and consist of the following at September 30:

	<u>2012</u>	<u>2011</u>
Money market	\$ 313,913	\$ 116,119
Fixed income:		
Intermediate term bond funds	520,809	482,206
Other bond funds	242,571	170,515
Equities:		
Mutual funds:		
Other funds	359,238	330,046
Large growth funds	332,860	237,047
Large blend funds	180,661	185,440
Exchange traded funds	<u>229,291</u>	<u>183,629</u>
	<u>\$2,179,343</u>	<u>\$1,705,002</u>

The following is a summary of the investment gains (losses) of the portfolio for the years ended September 30:

	<u>2012</u>	<u>2011</u>
Unrealized gains (losses) on investments	\$ 344,355	\$(266,667)
Net realized gains (losses) on investments	<u>(119,939)</u>	<u>96,787</u>
	<u>\$ 224,416</u>	<u>\$(169,880)</u>

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

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

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

Investment gains (losses) of \$21,086 and \$(11,053) for the years ended September 30, 2012 and 2011, respectively, at the request of a donor, are to remain in the endowment (see Note 4).

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(Continued)

(4) ENDOWMENT

Changes in endowment net assets by class are as follows:

	<u>Donor-Restricted</u>			<u>Total Endowment</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, September 30, 2010	\$ -	\$ 18,343	\$1,057,355	\$1,075,698
Investment return:				
Investment income	-	44,729	-	44,729
Net realized/unrealized losses	(10,298)	(53,282)	(11,053)	(74,633)
Total investment return	(10,298)	(8,553)	(11,053)	(29,904)
Contributions	-	-	495,074	495,074
Investment earnings - endowment appropriation for operations	-	(9,790)	-	(9,790)
Endowment net assets, September 30, 2011	(10,298)	-	1,541,376	1,531,078
Investment return:				
Investment income	-	26,645	-	26,645
Net realized/unrealized gains	10,298	130,797	21,086	162,181
Total investment return	10,298	157,442	21,086	188,826
Endowment net assets, September 30, 2012	\$ -	\$157,442	\$1,562,462	\$1,719,904

(5) NOTE PAYABLE TO A BANK

Earthwatch has available up to \$500,000 under a line of credit agreement with a bank. Borrowings under the agreement are due on demand and interest is payable monthly at the bank's base lending rate (3.25% at September 30, 2012 and 2011), plus 1%. The line of credit is secured by substantially all business assets of Earthwatch. No amount was outstanding under this agreement at September 30, 2012 and 2011.

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

EARTHWATCH INSTITUTE, INC.

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(6) OPERATING LEASES

On January 22, 2010, Earthwatch entered into a five-year lease agreement for office space in Allston, Massachusetts, commencing on May 1, 2010. This lease expires in April, 2015, and allows for a five-year renewal option. Earthwatch is responsible for its proportionate share of any increase in operating costs and real estate taxes over a base year and must maintain specified insurance coverage. Earthwatch is recognizing rent expense on a straight-line basis over the term of the lease in accordance with the *Accounting for Leases* standard under U.S. GAAP. For the years ended September 30, 2012 and 2011, Earthwatch recognized rent expense of \$264,439 and \$264,320 respectively. As of September 30, 2012 and 2011, accrued rent was \$53,378 and \$42,005, respectively.

Facility rent expense for the years ended September 30, 2012 and 2011, was \$282,760 and \$314,730, respectively, which includes tenant-at-will rent expense of approximately \$18,000 and \$46,000, respectively.

In fiscal year 2009, Earthwatch entered into a vehicle operating lease for staff at a regional climate center, which expired April, 2012, and was not renewed. Rent expense under this lease was \$2,408 and \$4,128 for the years ended September 30, 2012 and 2011, respectively.

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

<u>Fiscal Year</u>	<u>Facilities</u>
2013	\$277,317
2014	287,313
2015	<u>171,874</u>
	<u>\$736,504</u>

(7) INTANGIBLE ASSETS

Intangible assets of \$66,895 as of September 30, 2012 and 2011, consist of costs incurred by Earthwatch to register its trademarks in foreign countries. These intangible assets are not amortized; rather, they are tested for impairment on an annual basis to determine if the intangible assets are being carried on the statement of financial position at or above their implied value. An impairment exists when the implied fair value of the intangible assets is less than the corresponding carrying value of the intangible assets on the statement of financial position. Any impairment is recognized as a loss in the year the asset is determined to be impaired. There was no impairment loss at September 30, 2012 and 2011.

(8) EMPLOYMENT BENEFIT PLAN

Earthwatch maintains a qualified salary reduction plan (an IRC Section 401(k) plan), whereby employees who are 21 years of age and have accumulated 500 hours of service are eligible to make elective tax deferred contributions to the plan up to the maximum allowed by law. Earthwatch may contribute to the plan at the discretion of the Board of Directors and may match a portion of employee contributions. These matching contributions vest over a five year period. Earthwatch made contributions of \$69,566 and \$70,723 during fiscal years 2012 and 2011, respectively.

EARTHWATCH INSTITUTE, INC.
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(Continued)

(9) GRANTS AND PLEDGES RECEIVABLE

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

<u>Fiscal Year</u>	<u>2012</u>	<u>2011</u>
Less than one year	\$1,594,639	\$1,865,415
One to five years	<u>1,080,000</u>	<u>1,430,000</u>
	2,674,639	3,295,415
Less - discount	<u>15,544</u>	<u>27,349</u>
	2,659,095	3,268,066
Less - current portion	<u>1,594,639</u>	<u>1,865,415</u>
Long-term grants and pledges receivable, net	<u>\$1,064,456</u>	<u>\$1,402,651</u>

The pledges have been discounted using a 1.0% rate for fiscal years 2012 and 2011.

Earthwatch Europe's (see Note 2) grant receivable balances as of September 30, 2012 and 2011, were \$736,438 and \$658,338, respectively. These amounts represent approximately 28% and 20% of the total outstanding grants and pledges balance as of September 30, 2012 and 2011, respectively. Two other donors' balances represent approximately 59% of the outstanding pledge balance as of September 30, 2012. One other donor's balance represents approximately 56% of the outstanding pledge balance as of September 30, 2012.

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

In addition, Earthwatch received a \$150,000 grant, conditional upon meeting certain requirements. Although Earthwatch has not met the conditional requirements, the donor waived the requirements for the first and second installments of \$50,000. The remaining \$50,000 of the grant is expected to be recognized when Earthwatch meets the conditional requirements, which is expected to be in fiscal year 2013.

(10) CONCENTRATIONS AND CONTINGENCIES

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

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

EARTHWATCH INSTITUTE, INC.

**NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011**

(Continued)

(11) CONTINUING OPERATIONS

Earthwatch incurred an unrestricted surplus' from operations of \$763,254 and \$125,451 for the years ended September 30, 2012 and 2011, respectively. Temporarily restricted net assets from operations decreased by \$1,451,621 and \$888,105 for the years ended September 30, 2012 and 2011, respectively. As of September 30, 2012, Earthwatch had a deficit unrestricted operating net assets balance of \$707,002 and unrestricted current liabilities exceeded unrestricted current assets by \$1,102,383.

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

During fiscal years 2012 and 2011, Earthwatch achieved a surplus, benefiting from the actions taken by management in reducing operating costs, changing its service model, and reducing its portfolio of projects. Earthwatch also continued to benefit from cost reductions through the efficiencies of the shared costs with Earthwatch Europe (see Note 2). A restructure of the program delivery department along with additional cost reduction strategies were implemented during fiscal year 2012, which has resulted in reduced costs and Earthwatch will continue to monitor costs and processes in fiscal year 2013. In fiscal year 2013, management's main focus will be fundraising, continuing program delivery efficiencies and developing the public program. In management's opinion, these actions will allow Earthwatch to generate sufficient cash flows to meet its program commitments for fiscal year 2013.