

Institute of HeartMath

Financial Statements and
Supplementary Information

December 31, 2014
(With Comparative Totals
For the Year Ended December 31, 2013)

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Institute of HeartMath
Boulder Creek, California

We have audited the accompanying financial statements of Institute of HeartMath (a California nonprofit public benefit corporation), which comprise the statement of financial position as of December 31, 2014, and the related statements of activities and cash flows for the year 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 audit. We conducted our audit 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Institute of HeartMath as of December 31, 2014 and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

Institute of HeartMath's financial statements as of and for the year ended December 31, 2013 were audited by Berger Lewis Accountancy Corporation, whose practice became part of Armanino^{LLP} as of January 1, 2015, and whose report dated August 11, 2014, expressed an unmodified opinion on those statements. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of functional expenses on pages 21 - 22 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 2014 information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the 2014 information is fairly stated in all material respects in relation to the financial statements as a whole.

The 2013 schedule of functional expenses on pages 21 - 22 was subjected to the auditing procedures applied in the 2013 audit of the financial statements by Berger Lewis Accountancy Corporation, whose practice became part of Armanino^{LLP} as of January 1, 2015, and whose report on such information stated that it was fairly stated in all material respects in relation to the 2013 financial statements as a whole.

Armanino LLP

Armanino^{LLP}
San Jose, California

June 19, 2015

INSTITUTE OF HEARTMATH
Statement of Financial Position
December 31, 2014
(With Comparative Totals for 2013)

ASSETS

	<u>2014</u>	<u>2013</u>
Current assets		
Cash and cash equivalents	\$ 580,706	\$ 314,983
Accounts receivable	107,439	27,312
Accounts receivable - related parties	38,482	29,427
Royalties receivable - related parties	37,782	25,000
Other receivable - related parties	37,218	-
Prepaid expenses	28,111	19,090
Fiscal agency fund	<u>99,700</u>	<u>119,700</u>
Total current assets	<u>929,438</u>	<u>535,512</u>
Property and equipment, net	<u>1,311,528</u>	<u>1,311,407</u>
Other assets		
Investments	294,500	244,500
Mortgage loan fees, net	4,241	6,555
Research/heart intuition video, net	<u>12,500</u>	<u>29,167</u>
Total other assets	<u>311,241</u>	<u>280,222</u>
Total assets	<u>\$ 2,552,207</u>	<u>\$ 2,127,141</u>

LIABILITIES AND NET ASSETS

Current liabilities		
Accounts payable	\$ 63,953	\$ 58,956
Accounts payable - related parties	57,411	40,000
Accrued liabilities	45,524	46,274
Current portion of notes payable	21,435	20,022
Fiscal agency fund offset	99,700	119,700
Deferred revenue - related parties	148,872	12,500
Deferred revenue - other	<u>39,773</u>	<u>-</u>
Total current liabilities	<u>476,668</u>	<u>297,452</u>
Long-term liabilities, net of current portion		
Mortgage payable, net of current portion	1,016,672	1,038,333
Note payable - officer	<u>85,000</u>	<u>85,000</u>
Total long-term liabilities, net of current portion	<u>1,101,672</u>	<u>1,123,333</u>
Total liabilities	<u>1,578,340</u>	<u>1,420,785</u>
Net assets		
Unrestricted net assets	736,145	642,048
Temporarily restricted net assets	<u>237,722</u>	<u>64,308</u>
Total net assets	<u>973,867</u>	<u>706,356</u>
Total liabilities and net assets	<u>\$ 2,552,207</u>	<u>\$ 2,127,141</u>

The accompanying notes are an integral part of these financial statements.

INSTITUTE OF HEARTMATH
Statement of Activities
For the Year Ended December 31, 2014
(With Comparative Totals for 2013)

	2014			2013
	Unrestricted	Temporarily Restricted	Total	Total
Support and revenue				
Support				
Contributions	\$ 270,627	\$ 291,832	\$ 562,459	\$ 234,698
Contributions in-kind	<u>600</u>	<u>-</u>	<u>600</u>	<u>800</u>
Total support	<u>271,227</u>	<u>291,832</u>	<u>563,059</u>	<u>235,498</u>
Revenue				
Sales of educational materials and research products	994,893	-	994,893	944,247
Less: cost of sales	<u>(479,410)</u>	<u>-</u>	<u>(479,410)</u>	<u>(518,403)</u>
Gross profit - sales of educational materials and research product	515,483	-	515,483	425,844
Royalties	171,415	-	171,415	316,767
Education programs	599,098	-	599,098	466,901
Research services	203,624	-	203,624	174,349
Rental income	96,150	-	96,150	95,775
Interest and dividends	<u>691</u>	<u>-</u>	<u>691</u>	<u>1,517</u>
Total revenue	<u>1,586,461</u>	<u>-</u>	<u>1,586,461</u>	<u>1,481,153</u>
Net assets released from restrictions	<u>118,418</u>	<u>(118,418)</u>	<u>-</u>	<u>-</u>
Total support, revenue and net assets released from restrictions	<u>1,976,106</u>	<u>173,414</u>	<u>2,149,520</u>	<u>1,716,651</u>
Expenses				
Program services				
Education	978,665	-	978,665	993,704
Research	<u>570,837</u>	<u>-</u>	<u>570,837</u>	<u>549,230</u>
Total program services	<u>1,549,502</u>	<u>-</u>	<u>1,549,502</u>	<u>1,542,934</u>
Support services				
Management and general	260,371	-	260,371	256,197
Fundraising	<u>72,136</u>	<u>-</u>	<u>72,136</u>	<u>120,393</u>
Total support services	<u>332,507</u>	<u>-</u>	<u>332,507</u>	<u>376,590</u>
Total expenses	<u>1,882,009</u>	<u>-</u>	<u>1,882,009</u>	<u>1,919,524</u>
Change in net assets	94,097	173,414	267,511	(202,873)
Net assets, beginning of year	<u>642,048</u>	<u>64,308</u>	<u>706,356</u>	<u>909,229</u>
Net assets, end of year	<u>\$ 736,145</u>	<u>\$ 237,722</u>	<u>\$ 973,867</u>	<u>\$ 706,356</u>

The accompanying notes are an integral part of these financial statements.

INSTITUTE OF HEARTMATH
Statement of Cash Flows
For the Year Ended December 31, 2014
(With Comparative Totals for 2013)

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities		
Change in net assets	\$ 267,511	\$ (202,873)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	92,555	89,671
Donated stock	(50,000)	-
Change in operating assets and liabilities		
Accounts receivable	(80,127)	14,738
Accounts receivable - related parties	(9,055)	(14,701)
Royalties receivable - related parties	(12,782)	-
Prepaid expenses	(9,021)	(8,113)
Accounts payable	4,997	(4,418)
Accounts payable - related parties	17,411	632
Accrued liabilities	(749)	4,369
Deferred revenue - related parties	(12,500)	12,500
Deferred revenue - other	<u>39,773</u>	<u>-</u>
Net cash provided by (used in) operating activities	<u>248,013</u>	<u>(108,195)</u>
Cash flows from investing activities		
Principal payments on note receivable	-	449
Purchase of property and equipment	(73,696)	(32,552)
Prepayment received on sales of intellectual property	<u>111,654</u>	<u>-</u>
Net cash provided by (used in) investing activities	<u>37,958</u>	<u>(32,103)</u>
Cash flows from financing activities		
Principal payments on notes payable	<u>(20,248)</u>	<u>(18,909)</u>
Net cash used in financing activities	<u>(20,248)</u>	<u>(18,909)</u>
Net increase (decrease) in cash and cash equivalents	265,723	(159,207)
Cash and cash equivalents, beginning of year	<u>314,983</u>	<u>474,190</u>
Cash and cash equivalents, end of year	<u>\$ 580,706</u>	<u>\$ 314,983</u>
<u>Supplemental disclosure of cash flows information</u>		
Cash paid for interest	<u>\$ 71,830</u>	<u>\$ 73,214</u>

The accompanying notes are an integral part of these financial statements.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

1. General Information

The Institute of HeartMath (the "Organization" or "IHM"), now operating under the DBA HeartMath Institute, is an internationally recognized nonprofit research and education organization dedicated to helping people of all ages connect with the power and intelligence of their hearts and to self-regulate emotions to reduce stress, rebalance and rejuvenate. IHM has been researching heart intelligence, stress reduction, resilience and emotional management for almost two decades and has applied its findings to practical, easy to use stress reduction and learning tools and methods that have been developed and scientifically tested. Thousands of people in more than 50 countries have benefited from the life changing programs and services of IHM.

IHM's Education programs, practices, tools and technologies are helping tens of thousands of students build emotional flexibility and resilience, which promotes improved learner readiness, relationships, academic performance, classroom climate and more.

IHM's Research Center is a recognized global leader in emotional physiology, optimal function, resilience and stress management research. The center conducts basic research into psychophysiology, neuropathology and biophysics, and outcome studies in clinical, workplace, educational and military settings. IHM's research team frequently collaborates with universities, research centers and health care system partners. This research has significantly advanced understanding of heart brain interactions, heart rate variability (HRV) and heart rhythm coherence and the physiology of optimal learning and performance.

Research interests also include the electrophysiology of intuition and exploring how we are all globally interconnected at a deep, fundamental level via electromagnetic fields and bio-fields.

IHM collaborates with two for-profit companies: Quantum Intech (QI) and HeartMath LLC (HMLLC). QI develops, licenses, manufactures and distributes biometric and emotion regulation technology products. IHM has granted a worldwide exclusive license for the HeartMath System to QI, which in turn sublicenses it to partners around the world, including HMLLC. In return, the Organization receives a percentage of royalties and licensing fees from the trademarked and copyrighted materials and publications (see Note 17).

2. Program Services

I. Education

IHM's training and education programs, tools and technologies help children, parents, seniors, non-profit constituents, individuals, teens, veterans, military personal and families learn how to self-regulate emotions, increase emotional intelligence and reduce stress. Some highlights of 2014 are:

1. Center for Study of Social Policy, a DC policy think tank, just recognized Early HeartSmarts as an "effective program and practice guide for Expectant and Parenting Youth in foster care." This report will be "widely distributed" to the child welfare field.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

2. Program Services (continued)

2. Delivered HeartMath Certified Training Programs to 93 trainers. Qualified Personal Resilience Trainings to 91 mentors and HeartMath Interventions to 30 Trainers. Delivered 6 training programs offsite to organizations and Personal Resilience Mentoring to 20 individuals. Trainers deliver HeartMath resilience trainings to nonprofits, government service agencies, educators, counselors, teachers, administrators, school staff, the general public (free of charge), emergency service providers, health-care providers and services or incorporate HeartMath techniques into their existing training programs.
3. Presented at and participated in seven national education conferences in 2014.
4. Hosted four free public IHM Webinars with 15,891 people registering to attend.
5. Number of active members: 2,038.
6. Social Network Sites: Facebook: 349,240 fans, IHM Twitter: 31,964 followers, HeartMath My Kids!: 132,066 fans, HeartMath for Troops, Veterans and Families Facebook: 51,818 fans, IHM YouTube: 12,610 subscribers.
7. HeartMath Institute partnered with or helped to train people delivering programs in the military, law enforcement or to veterans, including:
 - a) Department of Justice Valor Program
 - b) Blue Courage
 - c) LA County Sherriff
 - d) Naval Special Warfare Development Group
8. Several clinics and/or educational centers partnering with behavioral health centers are using the HeartMath education technology and skillsets to enhance their offerings including this partial list:
 - a) Buffalo and Providence Psychiatric centers.
 - b) Hohm Press provided 6400 Heart to Heart books to the Florida Department of Children and their fourteen sites.
 - c) AspenPointe, a nonprofit multi-county mental health service provider in the Denver.
 - d) LaVista/Papillion School District Children's Behavioral Health, a part of Omaha Children's Hospital completed year two of an anxiety study with around 60 upper elementary/secondary students from 15 schools. The statistically significant results should be forthcoming in the next few months as a study submission to an education, psychology journal.
 - e) Neah Bay and the Makah Native American Nation.
9. Other educational institutions have implemented HeartMath technology and programs in various ways including:
 - a) South Dakota State University
 - b) Florida State University
 - c) Kansas State University
 - d) Pawtucket Public Schools

2. Program Services (continued)

II. Research

The Research center conducts basic research into psychophysiology, neurocardiology and biophysics, and outcome studies in clinical, workplace, educational and military settings, frequently in collaboration with universities, research centers and health-care-system partners.

Research interests also include the electrophysiology of intuition and exploring how we are all globally interconnected at a deep, fundamental level via electromagnetic fields and bio-fields. Some highlights of 2014 are:

1. Presented Research at seven Scientific Conferences and Symposiums in 2014.
2. The Research team provided: 814 Autonomic Assessment Reports, 4,418 psychometric survey forms and 2,741 Pre and Post Psychometric Survey reports for individuals, organizations and independent researchers.
3. New HMI Research Studies and Publications:
 - a) Shaffer, F., R. McCraty, and C. Zerr, A healthy heart is not a metronome: An integrative review of the heart's anatomy and heart rate variability. *Frontiers in Psychology*, 2014. 5:1040.
 - b) McCraty, R., Electrophysiology of Intuition: Pre-stimulus Responses in Group and Individual Participants Using a Roulette Paradigm. *Global Advances in Health and Medicine*, 2014. 3(2): p. 16-27.
 - c) McCraty, R. and M. Atkinson, Electrophysiology of Intuition: Pre-stimulus Responses in Group and Individual Participants Using a Roulette Paradigm. *Glob Adv Health Med*, 2014. 3(2): p. 16-27.
 - d) McCraty, R. and M. Atkinson, Biophysiology: Heart–Brain Interactions and Psychophysiological Coherence, in *Psychology's New Desing Science: Theory and Research*, S.I.J. SACHTER, Editor 2014, Common Ground Publishing LLC: Champaign, Illinois. p. 141-207.
 - e) McCraty, R. and M. Zayas, Intuitive Intelligence, Self-regulation, and Lifting Consciousness. *Glob Adv Health Med*, 2014. 3(2): p. 56-65.
 - f) McCraty, R. and M. Zayas, Cardiac coherence, self-regulation, autonomic stability, and psychosocial well-being. *Frontiers in Psychology*, 2014. 5(September): p. 1-13.2.
4. Studies by independent researchers utilizing HeartMath techniques and technologies:
 - a) Soer, R., et al., Heart Coherence Training Combined with Back School in Patients with Chronic Non-specific Low Back Pain: First Pragmatic Clinical Results. *Appl Psychophysiol Biofeedback*, 2014.
 - b) McCoy, K.M., et al., Evaluation of a Biofeedback Intervention in College Students Diagnosed with an Autism Spectrum Disorder. *DADD Online Journal*: p. 121.
 - c) Edwards, S.D., Effects of biofeedback training on physiological coherence, health and spirituality perceptions: sport and exercise psychology. *African Journal for Physical Health Education, Recreation and Dance*, 2014. 20(2.1): p. 500-510.

2. Program Services (continued)

- d) Edwards, S.D., Evaluation of a heartmath workshop for physiological and psychological variables. African Journal for Physical Health Education, Recreation and Dance, 2014. 20(1): p. 236-245.
- e) Klimov, D., et al., Biofeedback on heart rate variability in cardiac rehabilitation: practical feasibility and psycho-physiological effects. Acta Cardiol, 2014. 69(3): p. 299-307.
- f) Bothe, D.A., J.B. Grignon, and K.N. Olness, The effects of a stress management intervention in elementary school children. Journal of Developmental & Behavioral Pediatrics, 2014. 35(1): p. 62-67.
- g) Scolnick, B., D.I. Mostofsky, and R.J. Keane, Pilot study employing heart rate variability biofeedback training to decrease anxiety in patients with eating disorders. Journal of eating disorders, 2014. 2: p. 17.
- h) Lutz, B., An Institutional Case Study: Emotion Regulation With HeartMath at Santa Cruz County Children's Mental Health. Global Advances in Health and Medicine, 2014. 3(2): p. 68-71.
- i) Weltman, G., et al., Police Department Personnel Stress Resilience Training: An Institutional Case Study. Global Advances in Health and Medicine, 2014. 3(2): p. 72-79.
- j) Berry, M.E., et al., Non-pharmacological Intervention for Chronic Pain in Veterans: A Pilot Study of Heart Rate Variability Biofeedback. Global Advances in Health and Medicine, 2014. 3(2): p. 28-33.
- k) Rezaei, S., M. Mirzaei, and M. Reza Zali, Nonlocal Intuition: Replication and Paired-subjects Enhancement Effects. Global Advances in Health and Medicine, 2014. 3(2): p. 5-15.
- l) Whited, A., K.T. Larkin, and M. Whited, Effectiveness of emWave biofeedback in improving heart rate variability reactivity to and recovery from stress. Applied Psychophysiology and Biofeedback, 2014. 39(2): p. 75-88.

III. Global Coherence Initiative

The Global Coherence Initiative (GCI) is a science-based IHM project designed to help individuals and groups work together synchronistically and strategically to increase the impact of their individual efforts to create positive change on a global level.

- a) Tested potential sites for the Global Coherence Monitoring System in New Zealand and installed the site on the North Island, and installed the site that was previously located in the United Kingdom to its new home in Lithuania. Potential site locations were identified and testing arrangements were made for the installation of a site in South Africa with will take place in 2015.
- b) Maintained Global Coherence Monitoring System Sensor Sites in the United States, Saudi Arabia and Canada.
- c) Maintained the GCI website which hosts a Global Care Room that united GCI members from around the globe in a synchronous Heart Coherence Sessions totaling 101,157 unique visitors in 2014.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

2. Program Services (continued)

- d) Provided free information including webinars, training and resources to more than 57,195 GCI Members worldwide.
- e) Social Networking: GCI Facebook: 165,818 fans; GCI Twitter: 21,471 followers, GCI YouTube: 1,560 subscribers.
- f) Hosted the third event at the TAO Resort and Wellness Center in the Riviera Maya on the Yucatan Peninsula, Mexico for 60 attendees. This event was designed to help people learn how to increase access to their heart's intuitive intelligence and more effectively increase personal, social and global coherence.
- g) Hosted 12 GCI Care Focuses in the Global Care Room.
- h) Spoke at 15 events and conferences around the world in addition to numerous free teleseminars and webinars.

3. Summary of Significant Accounting Policies

Basis of accounting

The financial statements of Institute of HeartMath have been prepared on the accrual basis of accounting.

Basis of presentation

The Organization follows standards of accounting and financial reporting for voluntary health and welfare organizations as prescribed by the American Institute of Certified Public Accountants. In accordance with generally accepted accounting principles, the Organization reports its financial position and operating activities in three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Organization. Under this category, the Organization maintains an operating fund.

Temporarily restricted net assets include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.

Permanently restricted net assets include those assets which are subject to a non-expiring donor restriction, such as endowments. There were no permanently restricted net assets either at December 31, 2014 or December 31, 2013.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles includes the use of estimates that affect the financial statements. Accordingly, actual results could differ from those estimates.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

3. Summary of Significant Accounting Policies (continued)

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. The Organization maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Accounts, royalties and notes receivable

The Organization considers all accounts, royalties and notes receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary.

Property and equipment

Property and equipment are recorded at cost or estimated fair value for donated items. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 5 to 39 years. Equipment purchases over \$800 are capitalized. Depreciation is charged to the activity benefiting from the use of the property or equipment.

Accounting for impairment of long-lived assets

The Organization reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of the property and equipment may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the asset to future net cash flows, undiscounted and without interest, expected to be generated by the asset. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. As of December 31, 2014 and 2013, there were no events or changes in circumstances indicating that the carrying amount of the property and equipment may not be recoverable.

Intangible assets

See Note 7.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Fair value measurements

Fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

3. Summary of Significant Accounting Policies (continued)

A hierarchy has been established to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). Observable inputs are those that market participants would use in pricing the asset based on market data obtained from sources independent of the Institute of HeartMath. Unobservable inputs reflect the Institute of HeartMath's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Organization's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Accrued vacation

Vacation and sick pay are accrued for regular full-time employees at the rate of approximately 17 days per year. Vacation time carried over into the following fiscal year must be used by April 1st of that year. Accrued vacation and sick time represents vacation and sick time earned, but not taken as of December 31, 2014 and 2013, and is included in "accrued liabilities" in the statement of financial position. The accrued vacation and sick time balance was \$7,569 and \$12,602 as of December 31, 2014 and 2013, respectively.

Revenue recognition

The Organization recognizes support and revenue on the accrual basis of accounting. Revenue from grants classified as "exchange transactions", program fees, and research services are recognized as revenue in the period in which the service is provided.

Contributions

Contributions are recognized when the donor makes a pledge to give that is, in substance, an unconditional promise. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted depending on the nature of donor restrictions. Restricted contributions are reported as increases in restricted net assets. When the restriction is met the amount is shown as a reclassification of restricted net assets to unrestricted net assets.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

3. Summary of Significant Accounting Policies (continued)

Contributions in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. Contributed services, which require a specialized skill and which the Organization would have paid for if not donated, are recorded at the estimated fair value at the time the services are rendered.

Advertising and marketing

Advertising and marketing costs are charged to operations when incurred. Advertising costs was \$20,336 and \$14,260 for the years ended December 31, 2014 and 2013.

Expense allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities and in the schedule of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Indirect expense allocations are based on an analysis of personnel time, square footage and estimated use.

Income taxes

Institute of HeartMath is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements. In addition, the Organization qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Uncertainty in income taxes

Accounting principles generally accepted in the United States of America provide accounting and disclosure guidance about positions taken by an organization in its tax returns that might be uncertain. Management has considered its tax positions and believes that all of the positions taken by the Organization in its federal and state tax returns are more-likely-than-not to be sustained upon examination.

The Organization files information returns in the U.S. federal jurisdiction and state of California. The Organization's federal returns for the tax years 2011 and beyond remain subject to examination by the Internal Revenue Service. The Organization's California returns for the tax years 2010 and beyond remain subject to examination by the Franchise Tax Board.

Subsequent events

Management of the Institute of HeartMath has evaluated events and transactions subsequent to December 31, 2014 for potential recognition or disclosure in the financial statements. The Organization did not have subsequent events that required recognition or disclosure in the financial statements for the year ended December 31, 2014. Subsequent events have been evaluated through the date the financial statements became available to be issued, June 19, 2015.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

4. Comparative Financial Statements

Certain reclassifications have been made to the financial statements for the year ended December 31, 2013 for comparative purposes to conform with the presentation in the current year financial statements.

5. Fiscal Agency Fund

During the year ended December 31, 2013 IHM served as a fiscal agent for funds from Holos Institute of Health, Inc. (HIH) amounting to \$126,000. All funds received from HIH, with the exception of a one-time 5% service fee, taken by IHM, were deposited in a cash account maintained by IHM and included in the statement of financial position as "Fiscal Agency Fund" with a corresponding liability under current liabilities. As per HIH request, these funds are to be disbursed to the William A. Tiller Foundation, the parent organization for the William A. Tiller Institute of Psychoenergetic Research. Disbursements was \$20,000 and \$0 for the years ended December 31, 2014 and 2013, respectively. As of December 31, 2014 and 2013, the balance of Fiscal Agency Fund was \$99,700 and \$119,700, respectively.

6. Property and Equipment

At December 31, 2014 and 2013 the cost and related accumulated depreciation of property and equipment consisted of the following:

	<u>2014</u>	<u>2013</u>
Land	\$ 191,645	\$ 191,645
Land improvements	143,708	135,121
Buildings	1,125,159	1,093,000
Research equipment (GCI)	330,670	247,824
Furniture and fixtures	148,790	170,210
Vehicles	125,040	125,040
Computer equipment	<u>85,195</u>	<u>74,341</u>
	2,150,207	2,037,181
Less: accumulated depreciation	<u>(1,275,986)</u>	<u>(1,204,107)</u>
	874,221	833,074
Construction in progress (GCI and Health Project)	<u>437,307</u>	<u>478,333</u>
Property and equipment, net	<u>\$ 1,311,528</u>	<u>\$ 1,311,407</u>

Depreciation expense was \$73,575 and \$70,691 for the years ended December 31, 2014 and 2013, respectively.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

7. Intangible Assets

Intangible assets are amortized over their estimated useful lives. Intangible assets consisted of the following:

Lighthouse bank note costs

The Organization incurred \$11,567 in origination fees and legal costs associated with re-financing which are being amortized over the 5-year note period beginning October 2011.

Research/heart intuition video

For a cost of \$50,000, the Organization purchased a video that is an overview of the amazing and vital role of the heart in people's lives, and how personal energetics shapes social relationships and ultimately affects global consciousness. The video is being amortized over 3 years useful life, beginning October 2012.

	<u>2014</u>	<u>2013</u>
Total intangible assets	\$ 61,567	\$ 61,567
Accumulated amortization	<u>(44,826)</u>	<u>(25,845)</u>
Intangible assets - net	<u>\$ 16,741</u>	<u>\$ 35,722</u>

<u>Estimated annual amortization expense at December 31,</u>	<u>Amount</u>
2015	\$ 14,813
2016	1,928
Thereafter	<u>-</u>
Total	<u>\$ 16,741</u>

Amortization expense was \$18,980 and \$18,980 for the years ended December 31, 2014 and 2013, respectively.

8. Investments

The Organization has received donations of stock in Quantum Intech, a related company. The investment at the years ended December 31, 2014 and 2013 totaled \$294,500 and \$244,500, respectively. Fair value of this donated investment, was determined based primarily on historical valuations used for issuances of stock options (see Note 17).

Donated investments are reported at the assigned value at the date of receipt, which is then treated as the Organization's cost basis. The values assigned to private investments are based on available information and do not necessarily represent amounts which might ultimately be realized since such amounts cannot be reasonably determined until individual positions are liquidated. Consequently, estimated fair values may differ from the values that would have been used had a ready market existed for this investment.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

8. Investment (continued)

The balance of the investment as of December 31, 2014 and 2013 was calculated as follows:

	<u>2014</u>	<u>2013</u>
Balance as of January 1,	\$ 244,500	\$ 244,500
Contribution of stock	<u>50,000</u>	<u>-</u>
Balance as of December 31,	<u>\$ 294,500</u>	<u>\$ 244,500</u>

The following investment is classified as a Level 3 investment (see Note 3). The Organization's investment as of December 31, 2014 consisted of the following:

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Investment in private company stock	\$ 294,500	\$ -	\$ -	\$ 294,500
Total investment	<u>\$ 294,500</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 294,500</u>

9. Notes Payable

Notes payable as of December 31, 2014 and 2013 consisted of the following:

	<u>2014</u>	<u>2013</u>
<u>Lighthouse Bank note</u> , secured by real property located in Santa Cruz County, California, principal and interest payable monthly in 59 regular payments of \$7,669.08 beginning November 14, 2011, interest fixed at 6.75%. The loan was scheduled to mature October 14, 2016 with a balloon payment of approximately \$1,008,628 due at that date. The note was refinanced by Lighthouse Bank on April 8, 2015. The maturity date of the refinanced note is April 8, 2025.	\$ 1,038,107	\$ 1,058,355
<u>Officer note</u> , dated November 10, 2009, unsecured, payable in annual installments of \$1,700, including interest at 2%, that was waived. The unpaid principal balance that was due on November 11, 2012 has been extended based on IHM needs.	<u>85,000</u>	<u>85,000</u>
Total notes payable	1,123,107	1,143,355
Current portion of notes payable	<u>(21,435)</u>	<u>(20,022)</u>
Notes payable, net of current portion	<u>\$ 1,101,672</u>	<u>\$ 1,123,333</u>

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

9. Notes Payable (continued)

Future minimum principal payments on the notes are as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
2015	\$ 21,435
2016	1,016,672
Thereafter	<u>85,000</u>
	<u>\$ 1,123,107</u>

10. Line of Credit

The Organization has a \$100,000 line of credit with Lighthouse Bank, dated October 14, 2011. The line of credit is secured by the Organization's chattel paper, accounts, equipment and general intangibles and bears interest at prime rate plus 6% per annum, and matures October 14, 2014. The line of credit was renewed on October 14, 2014 and the maturity date extends to October 14, 2015. The amount available under this line of credit at December 31, 2014 and 2013 was \$100,000. As of December 31, 2014 and 2013, no amounts were outstanding.

11. Temporarily Restricted Net Assets

At December 31, 2014 and 2013 the Organization's temporarily restricted net assets consisted of:

	<u>2014</u>	<u>2013</u>
Global Coherence Initiative	\$ -	\$ 5,000
Military Service Appreciation Fund (formerly the Military Warrior Fund)	13,918	12,211
Education Scholarship Fund	18,834	7,750
Communities Fund	114	34
Green Dot School Project	1,753	1,753
Adopt a Scientist	7,528	36,810
Boys and Girls Club	1,000	750
Research Fund	9,591	-
Smart Brain Wise Heart Program	66,984	-
Heart Smart Program	78,000	-
Interconnectivity Program	35,000	-
Consciousness Project	<u>5,000</u>	<u>-</u>
Total temporarily restricted net assets	<u>\$ 237,722</u>	<u>\$ 64,308</u>

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

12. Net Assets Released from Restrictions

Net assets were released from restrictions during the year by incurring expenses satisfying the restricted purpose or by the expiration of time as follows:

	<u>2014</u>	<u>2013</u>
Global Coherence Initiative	\$ 23,862	\$ 44,144
Military Service Appreciation Fund (formerly the Military Warrior Fund)	23,335	20,516
Research Fund	5,568	2,821
Education Scholarship Fund	24,501	11,941
Communities Fund	-	6,685
Adopt a Scientist	34,596	25,701
Heart Mastery Program	-	4,276
Smart Brain Wise Heart Program	<u>6,556</u>	<u>-</u>
Total net assets released from restrictions	<u>\$ 118,418</u>	<u>\$ 116,084</u>

13. Contributions In-Kind

The estimated fair value of donated supplies, materials, equipment, and expert services are recorded as contributions. During the years ended December 31, 2014 and 2013, the following in-kind contributions were received by the Organization:

	<u>2014</u>	<u>2013</u>
Material and supplies	\$ <u>600</u>	\$ <u>800</u>
Total contributions in-kind	<u>\$ 600</u>	<u>\$ 800</u>

14. Contingencies

Grants and contracts awarded to Institute of HeartMath are subject to the funding agencies' criteria, contract terms and regulations under which expenditures may be charged and are subject to audit under such terms, regulations and criteria. Occasionally, such audits may determine that certain costs incurred in connection with the grants do not comply with the established criteria that govern them. In such cases, the Organization could be held responsible for repayments to the funding agency for the costs or be subject to a reduction of future funding in the amount of the costs. Management does not anticipate any material questioned costs for the contracts and grants administered during the period.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

15. Concentrations

One vendor, HeartMath LLC accounted for about 91% and 93% of cost of sales purchases for the years ended December 31, 2014 and 2013, respectively. HeartMath LLC also accounted for about 47% and 40% of total accounts payable as of December 31, 2014 and 2013, respectively. Total payables to HeartMath LLC include cost of goods sold bills for 23% and 21% of total cost of goods sold and expenses for the year ended 2014 and 2013, respectively.

16. Conflict of Interest Policy

Included among the Organization's Board of Directors and Officers are volunteers from the community who provide valuable assistance to the Organization in the development of policies and programs and in the evaluation of business transactions. The Organization has adopted a conflict of interest policy whereby Board members are disqualified from participation in the final decisions regarding any action affecting their related company or organization.

17. Related Party Transactions

Relationships and transactions with Quantum Intech (QI) and HeartMath LLC (HMLLC)

IHM collaborates with two for-profit companies: QI and HMLLC. QI develops, licenses, manufactures and distributes biometric and emotion-regulated technology products. IHM has granted a worldwide exclusive license for the HeartMath System to QI, which in turn sublicenses it to partners around the world, including HMLLC. In return, the Institute receives a percentage of royalties and licensing fees from the trademarked and/or copyrighted materials and publications.

While IHM maintains a clear legal and financial separation from HMLLC and QI, the three entities were founded by the same individuals and consider themselves "sister" organizations in pursuit of one mission: to facilitate a fundamental shift in health, well-being and consciousness. All these organizations operate under the HeartMath brand (under license from IHM) and are involved in the development of methods and technologies to help people self-regulate emotions and behaviors.

Accounts receivable

The related party receivables from HMLLC and QI was \$38,482 and \$29,427 as of December 31, 2014 and 2013, respectively.

Royalties income and receivable

For the period from January 1, 2014 through December 31, 2015, QI ("Licensee") shall pay IHM ("Licensor") minimum annual royalties of \$151,128 in monthly minimum installments of \$12,594. During the years ended December 31, 2014 and 2013, the royalty income amounted to \$151,128 and \$300,000, respectively. As of December 31, 2014 and 2013, royalties receivable from QI amounted to \$37,782 and \$25,000, respectively.

INSTITUTE OF HEARTMATH
Notes to Financial Statements
December 31, 2014

17. Related Party Transactions (continued)

Other receivable

In addition to the monthly minimum royalties, QI will advance \$12,406, monthly, as a non-refundable prepayment towards a potential future purchase of the rights it currently licenses from IHM. As of December 31, 2014, the prepayment from QI amounted to \$148,872 and is shown as deferred revenue - related parties in the statement of financial position and a prepayment receivable amounted to \$37,218.

Investment

The investment consists of donated stock in Quantum Intech, a related company (see Note 8).

HMLLC payable

At year end December 31, 2014 and 2013 IHM incurred related party payables to HMLLC of \$57,411 and \$40,000, respectively.

See vendor concentration related to HMLLC at Note 15.

Rental income

The Organization rented part of its building to various officers and employees of IHM and HMLLC. For the years ended December 31, 2014 and 2013, rental income from various related parties amounted to \$96,150 and \$95,775, respectively.

Note payable to officer

As of December 31, 2014, the Institute of HeartMath owed \$85,000 to an officer of the Institute (see Note 9).

SUPPLEMENTARY INFORMATION

INSTITUTE OF HEARTMATH
Schedule of Functional Expenses
For the Year Ended December 31, 2014
(With Comparative Totals For the Year Ended December 31, 2013)

	Program Services			Support Services			Totals	
	Education	Research	Total	Management and General	Fundraising	Total	2014	2013
Expenses								
Salaries and wages	\$ 244,554	\$ 244,245	\$ 488,799	\$ 127,893	\$ 15,762	\$ 143,655	\$ 632,454	\$ 643,659
Payroll taxes	18,708	18,685	37,393	9,784	1,206	10,990	48,383	49,241
Employee benefits	<u>29,463</u>	<u>32,954</u>	<u>62,417</u>	<u>23,034</u>	<u>2,411</u>	<u>25,445</u>	<u>87,862</u>	<u>96,060</u>
Total salaries and benefits	292,725	295,884	588,609	160,711	19,379	180,090	768,699	788,960
Outside services	270,667	134,159	404,826	944	20,645	21,589	426,415	402,956
Occupancy	114,024	10,322	124,346	22,086	810	22,896	147,242	153,333
Scholarships and training	48,041	-	48,041	-	-	-	48,041	70,242
Telephone	13,901	6,436	20,337	15,963	1,356	17,319	37,656	42,893
Maintenance	27,078	9,738	36,816	7,183	837	8,020	44,836	42,149
Travel	18,873	19,580	38,453	159	5,277	5,436	43,889	55,374
Bank charges and credit card merchant fees	38,668	212	38,880	127	4,182	4,309	43,189	40,564
Information technology & services	36,786	35,455	72,241	7,943	2,301	10,244	82,485	71,616
Supplies	11,035	7,090	18,125	2,127	1,440	3,567	21,692	20,262
Conferences, conventions, and meetings	18,768	1,749	20,517	-	81	81	20,598	19,331
Printing and publications	496	730	1,226	268	251	519	1,745	11,090
Donated supplies, materials and services	600	-	600	-	-	-	600	800
Legal and accounting fees	1,925	1,925	3,850	18,618	-	18,618	22,468	20,450
Licenses, fees and taxes	1,847	2,009	3,856	1,590	1,120	2,710	6,566	5,991
Insurance	4,300	3,237	7,537	4,737	285	5,022	12,559	12,697
Dues and subscriptions	5,873	3,829	9,702	643	1,307	1,950	11,652	16,364
Postage	3,409	662	4,071	2,380	6,425	8,805	12,876	21,282
Auto expense	-	-	-	3,696	-	3,696	3,696	3,696
Commissions	1,178	1,069	2,247	-	-	-	2,247	1,688
Educational materials	3,545	66	3,611	-	-	-	3,611	6,617
Advertising and marketing	9,752	4,742	14,494	25	5,817	5,842	20,336	14,260
Interest	25	19	44	3	1	4	48	93

INSTITUTE OF HEARTMATH
Schedule of Functional Expenses
(Continued)
For the Year Ended December 31, 2014
(With Comparative Totals For the Year Ended December 31, 2013)

	Program Services			Support Services			Totals	
	Education	Research	Total	Management and General	Fundraising	Total	2014	2013
Miscellaneous expenses	\$ 80	\$ -	\$ 80	\$ -	\$ -	\$ -	\$ 80	\$ 139
Office expense	1,644	549	2,193	7	4	11	2,204	3,124
Program development	187	-	187	-	-	-	187	749
Bad debts	<u>3,838</u>	<u>-</u>	<u>3,838</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,838</u>	<u>3,133</u>
Total expenses before depreciation and amortization	929,265	539,462	1,468,727	249,210	71,518	320,728	1,789,455	1,829,853
Depreciation and amortization	<u>49,400</u>	<u>31,375</u>	<u>80,775</u>	<u>11,161</u>	<u>618</u>	<u>11,779</u>	<u>92,554</u>	<u>89,671</u>
Total functional expenses	<u>\$ 978,665</u>	<u>\$ 570,837</u>	<u>\$ 1,549,502</u>	<u>\$ 260,371</u>	<u>\$ 72,136</u>	<u>\$ 332,507</u>	<u>\$ 1,882,009</u>	<u>\$ 1,919,524</u>
Percentage of total	<u>52.0 %</u>	<u>30.3 %</u>	<u>82.3 %</u>	<u>13.8 %</u>	<u>3.8 %</u>	<u>17.7 %</u>	<u>100.0 %</u>	