



Financial Statements

December 31, 2010 and 2009

DEMOCRASOFT, INC.

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December 31, 2010 and 2009

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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, 2010 and 2009, 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, 2010 and 2009, 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
April 5, 2011

DEMOCRASOFT, INC.

Balance Sheets

December 31, 2010 and 2009

	2010	2009
Assets		
Current assets		
Cash and cash equivalents	\$ 396,067	\$ 181,927
Investments in Treasury notes	3,597,936	6,442,297
Income tax receivable, including interest of \$108,534	-	898,213
Prepaid expenses and advances	19,110	2,948
Note receivable, related party	-	10,759
	4,013,113	7,536,144
Property and equipment, net	37,432	-
Other assets	8,740	8,740
	\$ 4,059,285	\$ 7,544,884
Liabilities		
Current liabilities		
Accrued expenses and accounts payable	\$ 67,774	\$ 70,239
Income tax payable	-	52,702
	67,774	122,941
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; 42,500,480 and 42,500,480 shares issued and outstanding, respectively	426	426
Additional paid-in-capital	67,398,137	67,382,442
Accumulated deficit	(62,576,596)	(59,149,753)
Shareholders' notes receivable, including accrued interest of \$177,518 and \$153,942, respectively	(839,308)	(820,232)
Accumulated other comprehensive income:		
Unrealized gain on marketable securities	8,852	9,060
	3,991,511	7,421,943
	\$ 4,059,285	\$ 7,544,884

See auditors' report and accompanying notes.

DEMOCRASOFT, INC.

Statements of Operations

Years Ended December 31, 2010 and 2009

	2010	2009
Revenue		
Patent sales and settlements	\$ -	\$ 2,600,000
Software license revenue	9,675	-
	9,675	2,600,000
Costs and expenses:		
General and administrative	1,477,896	1,414,323
Research and development		
Engineering	936,926	290,552
Sales and marketing	661,301	198,303
General administrative	376,228	84,867
Legal fees and costs associated with licensing revenue	-	52,514
	3,452,351	2,040,559
(Loss) income from operations	(3,442,676)	559,441
Other income (expenses):		
Interest income	23,623	148,439
Other income	104	368
Interest expense	(17,252)	(73,983)
Gain on sale of securities	17,777	17,746
Other taxes	(3,283)	65,768
	20,969	158,338
(Loss) income before income taxes	(3,421,707)	717,779
Income taxes	5,136	53,582
Net (loss) income	\$ (3,426,843)	\$ 664,197
Unrealized loss	(208)	(4,037)
Total comprehensive (loss) income	\$ (3,427,051)	\$ 660,160
Net (loss) income per share, basic	\$ (0.0807)	\$ 0.0437
Net (loss) income per share, diluted	\$ (0.0803)	\$ 0.0436
Weighted average number of common shares outstanding	42,500,480	42,057,740

See auditors' report and accompanying notes.

DEMOCRASOFT, INC.

Statements of Shareholders' Equity

Years Ended December 31, 2010 and 2009

	Common Stock	Amount	Shareholders' Notes	Accumulated Other Comprehensive Income	Additional Paid-In Capital	Accumulated Deficit	Total
Balance, December 31, 2008	40,900,480	\$ 410	\$ (1,637,890)	\$ 13,097	\$ 68,094,042	\$ (59,813,950)	\$ 6,655,709
Sale of stock, \$.09 per share	3,150,000	32	(28,350)	-	56,668	-	28,350
Cancellation of shares and notes receivable	(1,550,000)	(16)	775,000	-	(774,984)	-	-
Write off interested earned on cancelled notes receivable	-	-	123,489	-	-	-	123,489
Options granted	-	-	-	-	6,716	-	6,716
Net income	-	-	-	-	-	664,197	664,197
Unrealized loss on securities	-	-	-	(4,037)	-	-	(4,037)
Interest earned on notes receivable	-	-	(52,481)	-	-	-	(52,481)
Balance, December 31, 2009	42,500,480	426	(820,232)	9,060	67,382,442	(59,149,753)	7,421,943
Options granted	-	-	-	-	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	<u>42,500,480</u>	<u>\$ 426</u>	<u>\$ (839,308)</u>	<u>\$ 8,852</u>	<u>\$ 67,398,137</u>	<u>\$ (62,576,596)</u>	<u>\$ 3,991,511</u>

See auditors' report and accompanying notes.

DEMOCRASOFT, INC.

Statements of Cash Flows

Years Ended December 31, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Net (loss) income	\$ (3,426,843)	\$ 664,197
Adjustments to reconcile net (loss) income to net cash used by operating activities:		
Depreciation expense	10,192	-
Decrease in comprehensive income	(208)	(4,037)
Compensation expense for options granted	15,695	6,716
Realized gain on securities	(17,777)	17,746
Write off interest earned on cancelled notes receivable	-	123,489
(Increase) decrease in assets:		
Prepaid expenses and advances	(16,162)	-
Income tax receivable, including interest receivable	898,213	(174,469)
Interest receivable on shareholders' notes	(23,576)	(52,481)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(2,465)	54,572
State income taxes payable	(52,702)	51,902
Net cash (used in) provided by operating activities	(2,615,633)	687,635
Cash flows from investing activities:		
Proceeds from (investments in) sale of securities available-for-sale, net	2,862,138	(5,280,990)
Purchase of property and equipment	(47,624)	-
Proceeds from (payment to) note receivable, shareholder	10,759	(10,759)
Proceeds from notes receivable	4,500	-
Cash provided by (used in) investing activities	2,829,773	(5,291,749)
Cash flows provided by financing activities:		
Proceeds from sale of common stock	-	28,350
Net increase (decrease) in cash and cash equivalents	214,140	(4,575,764)
Cash and cash equivalents, beginning of year	181,927	4,757,691
Cash and cash equivalents, end of year	\$ 396,067	\$ 181,927
Supplemental disclosures:		
Income tax refund received	\$ 898,213	\$ -
Income taxes paid	\$ 74,000	\$ 1,640
Interest paid	\$ 17,252	\$ -
Non-cash transactions:		
Sale of stock applied to shareholders' notes	\$ -	\$ (28,350)
Cancellation of stock applied to shareholders' notes	-	775,000
	\$ -	\$ 746,650

See auditors' report and accompanying notes.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 1 - 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. The Company had no preferred stock outstanding as of December 31, 2010 and 2009.

Business - The Company has developed four applications built on a proprietary web-based platform which allows users to connect and interact online so that they can identify, refine and react to questions and ideas. While the Company does offer three of these applications for sale, the Company's primary activity is deploying its educational application of the platform (the fourth version) without charge to teachers, in anticipation of future monetization opportunities. The Company also monetizes its non-core intellectual property.

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. As of December 31, 2010, the Company had cash and cash equivalents of \$3,994,003. In 2010, Company experienced losses due to research and development of its new online software product which has not yet begun to generate significant revenue. As of December 31, 2010, has an accumulated deficit of approximately \$62,500,000.

The Company's management has identified certain revenue growth opportunities for 2011 related to its software launch and will look into possible financing resources to increase cash flow to continue the funding of the Company beyond 2011. Management expects that existing cash resources will be adequate to support the Company's operations through the year ending December 31, 2011, at a minimum.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Use of estimates - The accompanying financial statements have been prepared in conformity with U.S generally accepted accounting principles. 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. The Company maintains cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. From time to time, the Company had cash in financial institutions in excess of federally insured limits. As of December 31, 2010 and 2009, there were no cash balances in excess of FDIC limits.

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, 2010 and 2009, 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.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

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.

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.

For the years ended December 31, 2010 and 2009, there were no incremental shares.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

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. As of December 31, 2010 and 2009, a full valuation allowance was established against deferred tax assets. 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.

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, 2006, are subject to examination by federal and state tax authorities.

Advertising costs - Advertising costs are expensed as incurred. For the years ended December 31, 2010 and 2009, there were no advertising costs.

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

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

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 consolidated 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. For the years ended December 31, 2010 and 2009, no options were granted to nonemployees.

Subsequent events - Management has evaluated events and transactions for potential recognition or disclosure through April 5, 2011, which represents the date the financial statements were available to be issued. Management has determined that, as of that date, there were no subsequent events.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 2 - Investments in Securities Available-For-Sale

Investments consist exclusively of US Treasury notes. As of December 31, 2010 and 2009, the aggregate market value of investments exceeded their aggregate cost by \$8,852 and \$9,060, respectively.

As of December 31, 2010, investments consisted of the US Treasury note, due within one year, with fair value and cost, as follows:

	<u>2010</u>	<u>2009</u>
Fair market value	\$ 3,092,754	\$ 6,442,297
Cost	<u>3,083,902</u>	<u>6,433,237</u>
Unrealized gain	\$ <u>8,852</u>	\$ <u>9,060</u>

Note 3 - Fair Value Measurements

As of December 31, 2010 and 2009, the Company's assets at fair value set forth by level, within the fair value hierarchy, were as follows:

	<u>2010</u>	<u>2009</u>
U.S. government securities, level 1	\$ <u>3,092,754</u>	\$ <u>6,442,297</u>

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

As of the years ended December 31, 2010 and 2009, there were no level 2 or level 3 investments.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 4 - Property and Equipment

As of December 31, 2010 and 2009, property and equipment consisted of the following:

	<u>2010</u>	<u>2009</u>
Computer equipment	\$ 83,690	\$ 65,612
Furniture	44,094	20,669
Office equipment	11,121	5,000
Software	55,644	55,644
Trade show booth	<u>5,000</u>	<u>5,000</u>
	199,549	151,925
Less accumulated depreciation	<u>(162,117)</u>	<u>(151,925)</u>
	\$ <u>37,432</u>	\$ <u>-</u>

For the year ended December 31, 2010, depreciation expense totaled \$10,192. For the year ended December 31, 2009, there was no depreciation expense.

Note 5 - Notes Receivable - Shareholders

Stock subscriptions receivable that resulted from stock option exercises are reported as a deduction from shareholders' equity. As of December 31, 2010 and 2009, notes receivable-shareholders consisted of the following:

	<u>2010</u>	<u>2009</u>
Note receivable from employee bears interest at 3.65% per annum; secured by 500,000 shares of stock in the Company; due September 22, 2012.	\$ 376,982	\$ 376,982
Note receivable from employee bears interest at 3.65% per annum; secured by 156,975 shares of stock in the Company; due September 20, 2012.	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

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 5 - Notes Receivable - Shareholders (continued)

	<u>2010</u>	<u>2009</u>
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
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
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
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

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 5 - Notes Receivable - Shareholders (continued)

	<u>2010</u>	<u>2009</u>
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	666,290
Accrued interest on notes receivable	<u>177,518</u>	<u>153,942</u>
	\$ <u>839,308</u>	\$ <u>820,232</u>

On January 28, 2008, the Company issued 1,200,000 shares of non-lapse restriction stock to three of its board members; each board member received 400,000 shares of stock. Also, on January 28, 2008, the Company issued 1,450,000 to two of its employees; one employee received 1,400,000 shares and another received 50,000 shares. The shares are subject to a non-lapse restriction in the nature of substantially discounted right of first refusal. The shares sold are burdened with a perpetual right of first refusal pursuant to which the purchasers are required to first offer the shares to the Company for a period of five business days at a discount of \$.34 from whatever price a third party offers before they can be sold to that third party. The purchase price for the stock burdened with that right of first refusal was \$.07, payable 20% in cash and 80% by execution and delivery of a non-recourse promissory note due on December 31, 2016. The total amount of cash received by the Company for the issued shares was \$37,100. The total amount of non-recourse notes executed by the Board of Directors and employees of the Company was \$148,400.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 5 - Notes Receivable - Shareholders (continued)

On April 11, 2009, the Company issued 750,000 shares of non-lapse restriction stock to three of its board members; each board member received 250,000 shares of stock. Also, on April 11, 2009, the Company issued 2,400,000 to three of its employees; Richard Lang received 2,000,000 shares, Eric Walters received 300,000 and Colt Briner received 100,000 shares. The shares are subject to a non-lapse restriction in the nature of substantially discounted right of first refusal. The shares sold are burdened with a perpetual right of first refusal pursuant to which the purchasers are required to first offer the shares to the Company for a period of five business days at a discount of \$.102 from whatever price a third party offers before they can be sold to that third party. The purchase price for the stock burdened with that right of first refusal was \$.018, payable 50% in cash and 50% by execution and delivery of a non-recourse promissory note due on March 11, 2018. The total amount of cash received by the Company for the issued shares was \$28,350. The total amount of non-recourse notes executed by the Board of Directors and Employees of the Company was \$28,350.

On April 11, 2009, the Company cancelled 1,250,000 shares of common stock of Richard Lang, 250,000 shares of common stock of Eric Walters, and 50,000 shares of common stock of Colt Briner in exchange for their outstanding nonrecourse notes in the amounts of \$625,000, \$125,000 and \$25,000, respectively. As of April 11, 2009, accrued interest related on the notes was \$123,489. For the year ended December 31, 2009, the Company wrote off accrued interest of \$123,489 on its consolidated statements of operations.

Note 6 - Stock Options

On April 11, 2009, the Company adopted a 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.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 6 - Stock Options (continued)

As of December 31, 2010 and 2009, management determined that performance conditions were not probable for all stock option awards, except two awards where performance condition occurred before December 31, 2010 and 2009. Additionally, for the year ended December 31, 2010, there were 4 awards with no performance conditions where service conditions occurred. Consequently, for the years ended December 31, 2010 and 2009, the Company has recorded stock options compensation expense for those stock options vested of 200,000 and 92,000, or \$15,695 and \$6,716, respectively. The values of the stock option awards range from \$0.020 to \$0.306, depending on the grant date and the expected term, with the weighted average fair value of \$0.336 and \$0.076 for 2010 and 2009, respectively.

As of December 31, 2010, unrecognized compensation expense for the options granted was \$284,795.

The assumptions used in the calculation of the fair value of the options granted in 2010 and 2009, using the Black-Scholes model, were as follows:

Weighted average exercise price	\$0.25
Weighted average expected term (in years)	1-5
Expected volatility	137%-152%
Weighted average risk-free interest rate	1.6%-2.6%

For the years ended December 31, 2010 and 2009, there were no warrants granted.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 6 - Stock Options (continued)

The following is a summary of all options and warrants activity for the years ended December 31, 2010 and 2009:

	Options Outstanding		Warrants Outstanding	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Balance, December 31, 2008	260,000	\$ 2.99	645,334	\$ 1.56
Options/warrants granted	3,978,450	\$ 0.25	-	
Options/warrants expired	<u>(207,000)</u>	\$ 0.25	-	
Balance, December 31, 2009	4,031,450	\$ 2.99	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	<u><u>3,984,000</u></u>	\$ 0.25	<u><u>633,334</u></u>	\$ 1.56

As of December 31, 2010, stock options and warrants exercisable were as follows:

Options:

Exercise Price Per Share	Options Granted	Options Outstanding			Options Exercisable	
		Number Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$0.25	3,978,450	3,649,000	\$ 0.25	3.50	207,000	\$ 0.25
\$0.29	10,000	10,000	\$ 0.29	4.50	10,000	\$ 0.29
\$0.25	<u>325,000</u>	<u>325,000</u>	\$ 0.25	4.50	<u>75,000</u>	\$ 0.25
	<u><u>4,313,450</u></u>	<u><u>3,984,000</u></u>	\$ 0.25	3.58	<u><u>292,000</u></u>	\$ 0.25

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 6 - Stock Options (continued)

Warrants:

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
\$1.50	45,334	33,334	\$ 1.50	0.53	33,334	\$ 1.50
\$1.56	600,000	600,000	\$ 1.56	1.39	600,000	\$ 1.56
	645,334	633,334	\$ 1.56	1.35	633,334	\$ 1.56

Note 7 - Lease Commitments

Prior to November 15, 2009, The Company leased its office space under a one-year operating lease, which provided for one-year extensions. On November 15, 2009, the Company executed a new office lease on a different space in the same building, which provides for a 36 month term and is effective starting 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 the option of terminating the lease after the first year with 120 days notice.

Future minimum rental payments of these leases are as follows:

Year Ending December 31,

2011	92,900
2012	92,900
2013	7,700
	\$ 193,500

For the years ended December 31, 2010 and 2009, rent expense was \$71,786 and \$37,071, respectively.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 8 - Income Taxes

For the years ended December 31, 2010 and 2009, the provisions for federal and state income taxes are as follows:

	2010	2009
Current	\$ 5,136	\$ 53,582
Deferred	-	-
	\$ 5,136	\$ 53,582

As of December 31, 2010 and 2009, the Company had net operating loss carry-forwards for federal income tax purposes of approximately \$15,300,000 and \$12,700,000, respectively, subject to annual limitations, and are available to offset future taxable income, if any, through 2030.

As of December 31, 2010 and 2009, the Company had a net operating loss carryforward for state income tax purposes of approximately \$3,200,000 and \$1,000,000, respectively, subject to annual limitations, and is available to offset future taxable income, if any, through 2030.

As of December 31, 2010 and 2009, deferred tax assets, net, were comprised of the following:

	2010	2009
Deferred tax assets (liabilities):		
Net operating losses	\$ 5,483,641	\$ 4,377,067
Research and experimentation credit	463,841	449,832
Income tax recoverable	-	(74,743)
State income tax effect	272	17,062
Stock option compensation expense	9,007	2,877
Alternative minimum tax credit	79,079	-
Other	2,066	3,505
Total deferred tax assets, net	6,037,906	4,775,600
Less valuation allowance	(6,037,906)	(4,775,600)
	\$ -	\$ -

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 8 - Income Taxes (continued)

In assessing the amount of deferred tax assets to be recognized, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. It is not possible at this time to determine that the deferred tax assets are more likely to be realized than not. Accordingly, a full valuation allowance has been established for all years presented.

For the year ended December 31, 2010, the reconciliation between the federal statutory income tax rate and the Company's effective tax rate was as follows:

	<u>2010</u>
Income tax provision at federal statutory rates	\$ (1,162,111)
Current state income taxes, net of federal benefits	(199,418)
Net operating loss offset by valuation allowance	1,162,111
Permanent differences	277,905
Other	<u>(73,350)</u>
	<u>\$ 5,137</u>

Note 9 - Business Risks

The Company had no material revenue in 2010. 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.

DEMOCRASOFT, INC.

Notes to Financial Statements

December 31, 2010 and 2009

Note 10 - Revenue

Revenue from patents - During 2009, the Company sold its DVR patent (U.S. Patent no. 7,272,298), as well as several DVR-related pending U.S. patent applications to a non-affiliated company for a total one-time payment of \$2.3 million.

Revenue from settlements - During 2009, the Company entered into a settlement agreement with a major technology company. This settlement agreement provided the technology company with a non-exclusive license in exchange for a one-time payment to the Company of \$300,000. Legal fees and costs associated with this settlement totaled approximately \$52,500 (equal to 17.5% of the remaining gross settlement of \$300,000).

Note 11 - Related Party Transaction

In January 2009, a director borrowed \$46,000 from the Company. As of December 31, 2010, the balance was repaid.

Note 12 - Reclassifications

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