UNITED STATES NAVAL INSTITUTE AND AFFILIATE
Annapolis, Maryland

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011 and 2010

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CliftonLarsonAllen LLP
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Independent Auditor's Report

To the Board of Directors
United States Naval Institute and Affiliate
Annapolis, Maryland

We have audited the accompanying consolidated statements of financial position of the United States Naval Institute and Affiliate (collectively known as the Institute) as of December 31, 2011 and 2010, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Institute's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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 the Institute as of December 31, 2011 and 2010, 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.

CliftonLarsonAllen LLP

Baltimore, Maryland
March 30, 2012

CONSOLIDATED FINANCIAL STATEMENTS

UNITED STATES NAVAL INSTITUTE AND AFFILIATE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
December 31, 2011 and 2010

	2011	2010
ASSETS		
Cash	$ 349,475	$ 804,036
Accounts receivable, less allowance for doubtful accounts of $39,052 in 2011 and $85,000 in 2010	912,981	1,110,954
Contributions receivable, net	84,091	145,928
Inventory	2,208,411	2,202,388
Prepaid expenses and other assets	83,121	95,194
Investments	6,968,830	7,999,191
Property and equipment, net	2,466,232	2,882,211
Deferred publishing costs	191,873	183,804
TOTAL ASSETS	$ 13,265,014	$ 15,423,706
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable and accrued expenses	$ 1,389,931	$ 1,799,650
Deferred membership dues	2,835,080	3,035,080
Deferred subscriptions	660,807	679,790
Other deferred revenue	164,772	179,115
Maturities of future obligations	10,721	20,433
Unfunded pension obligation	2,979,735	1,776,661
Total liabilities	8,041,046	7,490,729
NET ASSETS		
Unrestricted	3,262,742	5,905,437
Temporarily restricted	893,174	959,588
Permanently restricted	1,068,052	1,067,952
Total net assets	5,223,968	7,932,977
TOTAL LIABILITIES AND NET ASSETS	$ 13,265,014	$ 15,423,706

The accompanying notes are an integral part of the consolidated financial statements.

UNITED STATES NAVAL INSTITUTE AND AFFILIATE
CONSOLIDATED STATEMENTS OF ACTIVITIES
Year Ended December 31, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2011
REVENUES, GAINS, AND PUBLIC SUPPORT				
Publication sales	$ 4,662,057	$ -	$ -	$ 4,662,057
Membership dues and subscriptions	1,945,576	-	-	1,945,576
Contributions	613,654	523,518	100	1,137,272
Advertising	1,192,832	-	-	1,192,832
Conference income	564,041	-	-	564,041
Investment income	63,423	68,156	-	131,579
Net realized and unrealized gain (loss) on investments	(116,518)	(92,956)	-	(209,474)
Royalties	189,934	-	-	189,934
Other income	10,196	-	-	10,196
Net assets released from restrictions:				
Satisfaction of program and time restrictions	565,132	(565,132)	-	-
Total revenues, gains, and public support	9,690,327	(66,414)	100	9,624,013
EXPENSES				
Program Services				
Publishing costs	5,589,758	-	-	5,589,758
Conference expenses	420,810	-	-	420,810
Royalties	318,965	-	-	318,965
Special projects	93,834	-	-	93,834
Other	319,234	-	-	319,234
Total program services	6,742,601	-	-	6,742,601
Supporting Services				
Administrative costs	3,581,413	-	-	3,581,413
Fundraising expense	557,174	-	-	557,174
Membership development	248,760	-	-	248,760
Total supporting services	4,387,347	-	-	4,387,347
Total expenses	11,129,948	-	-	11,129,948
Change in net assets from operating activities	(1,439,621)	(66,414)	100	(1,505,935)
Nonoperating				
Pension related changes other than net periodic pension costs	(1,203,074)	-	-	(1,203,074)
Change in net assets from nonoperating activities	(1,203,074)	-	-	(1,203,074)
CHANGES IN NET ASSETS	(2,642,695)	(66,414)	100	(2,709,009)
NET ASSETS, BEGINNING OF YEAR	5,905,437	959,588	1,067,952	7,932,977
NET ASSETS, END OF YEAR	$ 3,262,742	$ 893,174	$ 1,068,052	$ 5,223,968

The accompanying notes are an integral part of the consolidated financial statements.

UNITED STATES NAVAL INSTITUTE AND AFFILIATE
CONSOLIDATED STATEMENTS OF ACTIVITIES
Year Ended December 31, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2010
REVENUES, GAINS, AND PUBLIC SUPPORT				
Publication sales	$ 4,982,334	$ -	$ -	$ 4,982,334
Membership dues and subscriptions	2,081,917	-	-	2,081,917
Contributions	1,758,410	551,045	5,905	2,315,360
Advertising	1,178,910	-	-	1,178,910
Conference income	573,357	-	-	573,357
Investment income	162,592	31,257	-	193,849
Net realized and unrealized gain (loss) on investments	705,423	138,542	-	843,965
Royalties	129,394	-	-	129,394
Other income	8,679	-	-	8,679
Net assets released from restrictions:				
Satisfaction of program and time restrictions	596,048	(596,048)	-	-
Total revenues, gains, and public support	12,177,064	124,796	5,905	12,307,765
EXPENSES				
Program Services				
Publishing costs	5,662,989	-	-	5,662,989
Conference expenses	373,010	-	-	373,010
Royalties	382,008	-	-	382,008
Special projects	112,556	-	-	112,556
Other	465,492	-	-	465,492
Total program services	6,996,055	-	-	6,996,055
Supporting Services				
Administrative costs	3,021,393	-	-	3,021,393
Fundraising expense	625,905	-	-	625,905
Membership development	269,900	-	-	269,900
Total supporting services	3,917,198	-	-	3,917,198
Total expenses	10,913,253	-	-	10,913,253
Change in net assets from operating activities	1,263,811	124,796	5,905	1,394,512
Nonoperating				
Pension related changes other than net periodic pension costs	(59,393)	-	-	(59,393)
Change in net assets from nonoperating activities	(59,393)	-	-	(59,393)
CHANGES IN NET ASSETS	1,204,418	124,796	5,905	1,335,119
NET ASSETS, BEGINNING OF YEAR	4,701,019	834,792	1,062,047	6,597,858
NET ASSETS, END OF YEAR	$ 5,905,437	$ 959,588	$ 1,067,952	$ 7,932,977

The accompanying notes are an integral part of the consolidated financial statements.

UNITED STATES NAVAL INSTITUTE AND AFFILIATE
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ (2,709,009)	$ 1,335,119
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	462,050	458,726
Increase in inventory reserve	83,000	96,117
Increase (Decrease) in allowance for doubtful accounts and contributions receivable	(49,206)	14,945
Net unrealized and realized gains on investments	209,474	(843,965)
Contributions - permanently restricted	(100)	(5,905)
Effects of changes in operating assets and liabilities:		
Accounts receivable	243,921	620,491
Contributions receivable	65,095	(43,076)
Inventory	(89,023)	(167,683)
Prepaid expenses and other assets	12,073	27,551
Deferred publishing costs	(8,069)	10,033
Accounts payable and accrued expenses	(409,719)	126,525
Deferred membership dues	(200,000)	(189,385)
Deferred subscriptions	(18,983)	(18,436)
Other deferred revenue	(14,343)	92,388
Unfunded pension obligation	1,203,074	59,393
Net cash provided by (used in) operating activities	(1,219,765)	1,572,838
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(46,071)	(177,643)
Purchase of investments	(81,812)	(889,482)
Proceeds from sales and maturities of investments	902,699	250,356
Net cash provided by (used in) investing activities	774,816	(816,769)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments to reduce long-term obligations	(9,712)	(218,874)
Permanently restricted contributions	100	5,905
Net cash used in financing activities	(9,612)	(212,969)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(454,561)	543,100
CASH, BEGINNING OF YEAR	804,036	260,936
CASH, END OF YEAR	$ 349,475	$ 804,036
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	$ -	$ 4,896

The accompanying notes are an integral part of the consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The United States Naval Institute (the Institute) is a voluntary, private, nonprofit association formed in 1873 for "the advancement of professional, literary, and scientific knowledge in the naval and maritime services, and the advancement of the knowledge of sea power." The membership includes officers and enlisted personnel of all branches of the military services, officers of foreign navies, and United States and foreign citizens interested in sea power and maritime affairs.

The Naval Institute Foundation, Inc. (the Foundation) was organized exclusively to raise funds for charitable and educational purposes to further the mission and policies of the United States Naval Institute. Funds raised are to be used as directed by the Institute's Board of Directors.

The Foundation's Board of Trustees was organized to manage the business and affairs of the Foundation provided all action taken by the Foundation's Board shall be strictly in compliance with the policies of the Institute's Board of Directors. Therefore, the Foundation is included in the consolidated financial statements of the Institute as an affiliate.

Basis of Accounting

The Institute prepares its consolidated financial statements on the accrual basis of accounting in accordance with generally accepted accounting principles as they pertain to Not-for-Profit organizations. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

Consolidation Policy

The accompanying consolidated financial statements include the accounts of the United States Naval Institute and its affiliate, the Naval Institute Foundation, Inc. and are collectively referred to as the Institute. All significant transactions between the organizations, including all inter-organizational accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Institute reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets consist of funds currently available to support the Institute's operations. Gains or losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets.

Temporarily restricted net assets result from contributions whose use is limited by donor-imposed stipulations that either expire by the passage of time or can be fulfilled and removed by actions of the Institute pursuant to those stipulations. Net assets may be temporarily restricted for various purposes, such as use in future periods or use for specified purposes.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (continued)

When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. Temporarily restricted net assets consist of the unspent portion of temporarily restricted contributions received by the Institute for various programs and investment income earned on temporarily and permanently restricted contributions. Any temporarily restricted resource that is received and used during the same year is considered an unrestricted resource and is reported as unrestricted support and expense.

Permanently restricted net assets consist of assets whose use by the Institute is limited by donor-imposed restrictions that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Institute. The restrictions stipulate that resources be maintained permanently but permit the Institute to expend the income generated in accordance with the provisions of the agreement.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain 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.

As discussed in Note 13, the Institute sponsors a defined pension plan and the discount rate and expected rate of return on plan assets are critical assumptions which significantly affect pension accounting. Even relatively small changes in these rates would significantly change the recorded pension expense and accrued liability. Management believes the discount rate and expected rate of return on plan assets used in determining its year-end pension accounting are reasonable based on currently available information. However, it is at least reasonably possible that these assumed rates will be revised in the near term, based on future events and changes in circumstances.

Cash and cash equivalents

The Institute maintains all of its cash in one commercial bank located in Charlotte, North Carolina. Balances on deposit are insured by the Federal Deposit Insurance Corporation (FDIC) up to specified limits. Balances in excess of FDIC limits are uninsured. Total cash held by the bank was $432,000 and $819,000 at December 31, 2011 and 2010, respectively. The Institute considers all liquid investments with maturities of three months or less when purchased to be cash equivalents.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable and Allowance for Doubtful Amounts

Accounts receivable are customer obligations due under normal trade terms. The allowance for doubtful amounts is based on certain percentages of aged receivables, which are determined based on management's historical experience and assessment of the general financial conditions affecting the customer base.

If actual collections experience changes revisions to the allowance may be required. A limited number of customers have individually large amounts due at any given date. Any unanticipated change in one of those customers' credit worthiness or other matters affecting the collectability of amounts due from such customers could have a material effect on the Institute's changes in net assets in the period in which such changes or events occur. An account is delinquent when payment is not received by the payment terms agreed to by the customer and the Institute. Payment terms vary by customer and are based on credit worthiness and history with the customer. The Institute does not charge interest to customers with account balances past due. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Contributions Receivable

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in contribution revenue.

Conditional promises to give are not included as support until the conditions are substantially met.

The Institute uses the allowance method to determine the uncollectible amounts of contributions receivable. The allowance is based upon prior years' experience and management's analysis of subsequent collections.

As of December 31, 2011 and 2010, the Institute believes that the allowance for uncollectible amounts is adequate.

Inventory

Inventories are carried at the lower of cost or market, and are valued using the average cost method of inventory valuation. Included in inventory are costs of publications held for sale, certificates and production costs of publications not completed at year end.

The Institute has established an allowance for obsolete inventory based on management's analysis and prior experience.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments

Investments are reported at fair value. Fair value is the price that would be received to sell an asset of paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 2 for discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Dividends are recorded on the ex-dividend date. Interest income is recorded on the accrual basis. Net appreciation in fair value of investments includes gains and losses on investments bought and sold as well as held during the year. Investment income or loss is included in the change in unrestricted net assets unless their use is temporarily or permanently restricted by donor stipulations or by law.

Property and Equipment

Property and equipment is recorded at historical cost or, if donated, such assets are capitalized at the estimated fair value at the date of receipt. Depreciation is computed using the straight-line method over the following estimated useful lives:

Office facilities	10 - 30 years
Furniture and fixtures	3 - 10 years
Automobiles and equipment	3 - 10 years

The Institute capitalizes fixed assets with a useful life greater than one year and with an original cost of $3,000 or greater. When assets are sold or disposed of, the cost and corresponding accumulated depreciation and amortization are removed from the books with any gain or loss recognized currently. Expenditures for repairs and maintenance are charged to expense as incurred.

Endowment Fund Management Policy

The Foundation adopted the guidance for accounting and disclosure of endowment funds, which requires that the amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, determined by the organization's governing board, must be retained permanently consistent with the relevant law.

Income Taxes

The Institute and Foundation have been granted exemptions by the Internal Revenue Service (IRS) from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The IRS has also determined that the Institute is not a private foundation. Separate tax returns are filed for the Institute and Foundation. The Institute and Foundation are required to report unrelated business income to the IRS and Maryland, as well as pay certain other taxes to local jurisdictions. Neither the Institute nor the Foundation had any unrelated business income for the years ended December 31, 2011 and 2010.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of Long-Lived Assets

The Institute reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or the fair value less costs to sell.

Revenue Recognition

Contributions are reported in accordance with the provisions of FASB ASC 958-605, which defines a contribution as an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

Contributions, Grants and Donated Assets

Contributions, donated marketable securities, and other noncash donations received by the Foundation are presented at their fair values on the date of such gifts.

Deferred Publishing Costs

These costs represent advance royalties on unpublished manuscripts awaiting publication for books. They offset future royalty payments when the manuscripts become part of a published product, or expensed if abandoned.

Deferred Revenue

Membership Dues
Payments for memberships received in advance are deferred and recognized as revenue over the length of the membership terms.

Deferred Subscriptions
Payments for subscriptions received in advance are deferred and recognized as revenue over the length of the subscription terms.

Other Deferred Revenue
Includes payments for royalties and other receipts received in advance which are deferred and recognized as revenue over the length of the royalty and other agreed upon terms.

Deferred Life Member Dues
Payments for life memberships received are deferred and recognized as revenue over estimated membership terms.

Expenses

Expenses are recognized by the Institute in the period in which they are incurred. Expenses paid in advance and not yet incurred are deferred to the applicable period.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Functional Allocation of Expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the Consolidated Statements of Activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Financial Instruments and Credit Risk

Financial instruments, which potentially subject the Institute to concentration of credit risk, consist principally of cash and investments. The Institute places its cash and investments with creditworthy financial institutions. At times, cash balances may exceed federally insured limits. The Institute has not experienced any losses in such accounts. Credit risk with respect to investments is generally limited, because by policy, the investments are kept within limits designed to prevent risks caused by concentration.

NOTE 2 – INVESTMENTS

Investments consist of the following as of December 31:

	2011		2010	
	Cost	**Market**	**Cost**	**Market**
TIFF multi-asset fund	$ 6,538,442	$ 5,911,319	$ 7,157,350	$ 6,901,950
Corporate Stock	765,546	1,029,030	765,546	1,070,583
Certificates of deposit	26,500	28,481	26,500	26,658
Total	$ 7,330,488	$ 6,968,830	$ 7,949,396	$ 7,999,191

The following schedule summarizes the investment return for the years ended December 31:

	2011	2010
Investment income	$ 131,579	$ 193,849
Realized/unrealized gains/(losses), net	(209,474)	843,965
Total	$ (77,895)	$ 1,037,814

Investment income is net of management fees amounting to $4,642 and $5,364 in 2011 and 2010, respectively.

At December 31, 2011, the fair value of the TIFF multi-asset fund had depreciated approximately 9.6% from the Institute's cost basis, which is equivalent to a cumulative unrealized loss of $627,123. Because the Institute does not intend to sell the investment and it is not more-likely-than-not that the Institute will be required to sell the investment before recovery of their cost basis, the Institute does not consider this investment to be other than temporarily impaired at December 31, 2011.

NOTE 3 – FAIR VALUE MEASUREMENT

In determining fair value, the Institute uses valuation approaches within the fair value measurement framework. Fair value measurements are determined based on the assumptions that market participants would use in pricing an asset or liability.

The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1
Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Institute has the ability to access.

Level 2
Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable for the asset or liabilities.
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3
Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2011 and 2010:

TIFF multi-asset fund
The Foundation's investment in the TIFF Multi-Asset fund is representative of a mutual fund vehicle that provides diversification by investing in various strategies including marketable equity securities, securities sold and other financial instruments including futures, forwards, and swap contracts. The values are primarily based on the financial data supplied by the investment managers of the underlying funds. Individual investment holdings may include investments in both nonmarketable and market-traded securities. Securities for which market quotations are readily available are valued based on the last quoted sales price. Unlisted securities for which over-the-counter market quotations are readily available are valued based on the latest bid price.

NOTE 3 – FAIR VALUE MEASUREMENT (CONTINUED)

Nonmarketable securities may include equity in private companies, real estate, thinly traded securities, and other investment vehicles. Certain funds are valued using a fair value model to reflect events affecting the values of certain portfolio securities. Investments in private investment funds are valued based on the fund's interest in the private investment fund as determined by that private investment fund. An estimated value is used by the fund if the private investment fund does not provide a timely value to the fund. Securities for which market quotations are not readily available are valued at fair value as determined in good faith under procedures established by TIFF's Board of Directors. These procedures include the effect of restrictions on resale, industry analysis and trends, significant changes in the issuer's financial position and any other significant events. The investments may directly expose the Institute to the effects of securities lending, short sales of securities, and trading in futures and forward contracts, options, swap contracts, and other derivative products. While these financial instruments contain varying degrees of risk, the Institute's exposure with respect to each such investment, is limited to its carrying amount (fair value as described above) in each investment. The Institute does not directly invest in the underlying securities of the investment funds, and due to restrictions on transferability and timing of withdrawals from the multi-asset fund, the amounts ultimately realized upon liquidation could differ from reported values that are based on current conditions. These investments are classified within Level 2 of the valuation hierarchy.

Certificates of deposit
Certificates of deposit are generally valued at the most recent bid price of the equivalent quoted yield for such securities (or those of comparable maturity, quality, and type). The Institute's investments in certificate deposits consist of securities earning a fixed interest rate with a maturity of longer than three months. The certificates of deposits are valued based on the cost of the security and the stated rate of interest the security is expected to yield. This investment is classified within Level 2 of the valuation hierarchy.

Corporate stock
Corporate stocks listed on a national market or exchange are valued at the last sales price, or if there is no sale and the market is still considered active, at the mean of the last bid and asked prices on such exchange. These investments are classified within Level 1 of the valuation hierarchy.

Charitable gift annuity obligation
The charitable gift annuity having no observable market is valued on Level 3 inputs based on assumptions using life expectancy tables and risk-free discount rates to record the gift annuity at fair value.

NOTE 3 – FAIR VALUE MEASUREMENT (CONTINUED)

Below sets forth a table of assets and liabilities measured at fair value as of December 31, 2011 and 2010.

	2011			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Quoted Prices for Similar Assets and Liabilities in Active Markets (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Fair Value as of December 31, 2011**
Corporate stock:				
Financial	$ 1,029,030	$ -	$ -	$ 1,029,030
Certificate of deposits	-	28,481	-	28,481
Mutual funds:				
TIFF multi-asset fund	-	5,911,319	-	5,911,319
Total investments	1,029,030	5,939,800	-	6,968,830
Charitable gift annuity obligation	-	-	(10,721)	(10,721)
Total	$ 1,029,030	$ 5,939,800	$ (10,721)	$ 6,958,109

	2010			
Description	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Quoted Prices for Similar Assets and Liabilities in Active Markets (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Fair Value as of December 31, 2010**
Corporate stock:				
Financial	$ 1,070,583	$ -	$ -	$ 1,070,583
Certificate of deposits	-	26,658	-	26,658
Mutual funds:				
TIFF multi-asset fund	-	6,901,950	-	6,901,950
Total investments	1,070,583	6,928,608	-	7,999,191
Charitable gift annuity obligation	-	-	(20,433)	(20,433)
Total	$ 1,070,583	$ 6,928,608	$ (20,433)	$ 7,978,758

The following is a reconciliation of the beginning and ending balances of assets and liabilities measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the year ended December 31, 2011:

	Charitable Gift Annuity	
Assets at Fair Value Using Unobservable Inputs (Level 3)	**2011**	**2010**
Balance – January 1	$ (20,433)	$ (12,221)
Settlements	9,712	(8,212)
Balance – December 31	$ (10,721)	$ (20,433)

NOTE 4 – INVENTORY

Inventory consists of the following at December 31:

	2011	2010
Publications held for sale	$ 2,842,320	$ 2,760,434
Prepublication costs	70,753	56,852
Certificates	35,338	42,102
	2,948,411	2,859,388
Less allowance for obsolete inventory	740,000	657,000
Total	$ 2,208,411	$ 2,202,388

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following at December 31:

	2011	2010
Unconditional promises to give	$ 99,091	$ 164,186
Less allowance for uncollectible amounts	15,000	18,258
Net unconditional, promises to give	$ 84,091	$ 145,928
Amounts due in:		
Less than one year	$ 73,782	$ 74,796
One to five years	6,309	71,132
Total	$ 84,091	$ 145,928

The revenue related to multi-year unrestricted contributions receivable is classified as temporarily restricted revenue in the accompanying Consolidated Statements of Activities due to time restrictions.

NOTE 6 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31:

	2011	2010
Office facilities	$ 3,053,539	$ 3,053,539
Computer equipment and software	1,838,429	1,810,141
Furniture, fixtures, and office equipment	546,997	529,214
Automobiles and warehouse equipment	41,343	41,343
	5,480,308	5,434,237
Less accumulated depreciation and amortization	3,014,076	2,552,026
Total	$ 2,466,232	$ 2,882,211

Depreciation and amortization expense for the years ended December 31, 2011 and 2010 was $462,050 and $458,726, respectively.

NOTE 7 – FUTURE OBLIGATIONS

Charitable Gift Annuity

The Institute received a cash contribution of $100,000 in the form of a charitable gift annuity. The liability under the agreement is recorded at the net present value of the estimated income owed to the donor based upon the donor's life expectancy. The discount is computed using the risk-free rate of 1.80%. The agreement stipulates that the donor is to receive monthly payments for the remainder of her life based on life expectancy tables. Any income not distributed will revert to the Foundation at the termination of the agreement.

Anticipated maturities of the annuity are as follows for the years ending December 31:

2012	$	9,888
2013		833
		10,721

NOTE 8 – COMMITMENTS/CONTINGENCIES

Contract with Key Employees

The Institute has executed three employment contracts with key employees, which will continue unless terminated in accordance with the terms of the agreements. In the event of termination without cause, the Institute guarantees lump sum payments ranging from three months up to one year of the annual base salary plus a prorated amount of any annual performance bonus that would have been received in the fiscal year in which the employment was terminated.

NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS

These net assets are restricted to the following purposes at December 31:

	2011	2010
Naval Institute Press Subvention	$ 363,408	$ 226,493
Essay Contests	287,361	351,121
Other	78,787	129,835
Time restricted net assets	43,981	47,478
Conferences	41,080	29,869
Photo Archives	26,137	41,541
Oral History	52,420	133,251
Total	$ 893,174	$ 959,588

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS

These assets are restricted to the following purposes at December 31:

	2011	2010
General Program Support Endowments	$ 500,912	$ 500,812
Essay Contests Endowments	338,721	338,721
Oral History Endowment	124,237	124,237
Photo Archives Endowment	59,731	59,731
Other Program Endowments	36,000	36,000
Conference Endowment	2,721	2,721
Book Subvention Endowment	5,730	5,730
Total	$ 1,068,052	$ 1,067,952

NOTE 11 – ENDOWMENT

The Institute's endowment consists of individual funds established for a variety of purposes. As required by generally accepted accounting principles, net assets associated with endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of the Institute has interpreted the Maryland Uniform Prudent Management of Institutional Funds Act (MUPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. Consequently, the Institute classifies permanently restricted net assets as:

- The original value of gifts donated to the permanent endowment, and
- The original value of subsequent gifts to the permanent endowment.

The remaining portion of the donor-restricted endowment fund not classified as permanently restricted is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Institute's Board. In accordance with MUPMIFA, the Institute considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

1. The duration and preservation of the fund
2. The purpose of the Institute and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Institute
7. The investment policies of the Institute

NOTE 11 – ENDOWMENT (CONTINUED)

Return Objectives and Risk Parameters

The Institute has invested its endowment assets in a manner that attempts to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, the endowment assets are invested in a manner that is intended to produce approximately 5% greater than the rate of inflation as measured by the Consumer Price Index, and above the median of the Lipper Peer Universes. Actual returns in a given year may vary from this amount.

Spending Policies of the Endowments

The Institute allocates the investment income generated by the endowment each year based on the purpose of the endowment based on the donor's request. If the donor does not specify a purpose for the income generated from their permanently restricted endowment, the income is used for general support and is distributed annually. The Institute seeks to allocate 4-5% of the income generated from the endowments.

Endowment Net Asset Composition by Type of Fund as of December 31, 2011 and 2010:

	2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ 138,508	$ 1,068,052	$ 1,206,560

	2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ 159,478	$ 1,067,952	$ 1,227,430

The following table represents the changes in endowment net assets at December 31:

	2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ -	$ 159,478	$ 1,067,952	$ 1,227,430
Investment return	-	(20,970)	-	(20,970)
Contributions	-	-	100	100
Total	$ -	$ 138,508	$ 1,068,052	$ 1,206,560

NOTE 11 – ENDOWMENT (CONTINUED)

	2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ -	$ 22,489	$ 1,062,047	$ 1,084,536
Investment return	-	136,989	-	136,989
Contributions	-	-	5,905	5,905
Total	$ -	$ 159,478	$ 1,067,952	$ 1,227,430

NOTE 12 – DESCRIPTION OF PROGRAM AND SUPPORTING SERVICES

The following program and supporting services are included in the accompanying consolidated financial statements.

Publishing Costs

Includes costs of producing Proceedings and Naval History: two magazines which feature diverse articles from naval professionals and civilian experts featuring historical essays and current topics. Additionally, the Institute also publishes several hundred books. The titles range from how-to books on boating and navigation to battle histories, biographies, ship and aviation guides, paperback works of fiction and non-fiction, and professional manuals.

Conference Expenses

The Institute provides for various seminars and meetings, throughout its fiscal year, on current and historical topics. These meetings offer a concentrated opportunity for the exchange of ideas and discussion of key naval issues among naval professionals and others.

Royalties

Represent agreed-upon payments made by the Institute to various authors for their respective books. The amount of the royalty is based upon the actual sales of the respective books and any sales of subsidiary rights.

Special Projects

Represent various projects undertaken to further scientific, professional, and literary knowledge of sea power and the maritime services.

Other

Represent other expenses necessary to further the mission and policies of the Institute.

NOTE 12 – DESCRIPTION OF PROGRAM AND SUPPORTING SERVICES (CONTINUED)

Administrative Costs

Includes the expenditures necessary to secure proper administrative functioning of the Institute including managing the financial and budgetary responsibilities of the Institute and supporting the Board of Directors.

Fundraising Expense

Provides the structure necessary to encourage and secure private financial support from individuals, foundations, and corporations.

Membership Development

Membership development activities include soliciting for prospective members, membership relations, and similar activities.

NOTE 13 – PENSION PLAN

The Institute sponsors a defined benefit pension plan (the Plan) that covers certain of its employees. The Plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service and compensation rates near retirement. Contributions to the Plan reflect benefits attributed to employees' services to date, as well as benefits expected to be earned in the future. Plan assets consist primarily of domestic and international equity funds and fixed-income funds.

The Institute's funding policy is to make contributions to the extent required by the Employee Retirement Income Security Act.

The Plan was amended to freeze benefits accrued thereunder as of June 1, 2003. No further benefits shall accrue to participants and no employee of the Institute who was not already a participant in the Plan as of June 1, 2003 shall become a participant after that date.

The following is a summary of the funded status of the Plan as of December 31, the key assumptions used by the Plan's actuary, and the cost to the Institute of providing retirement benefits subsequent to the adoption of FASB ACS 715.

Change in Benefit Obligations

	2011	2010
Benefit obligation, beginning of year	$ (9,984,154)	$ (9,849,717)
Service cost	-	(512)
Interest cost	(570,298)	(567,860)
Actuarial loss	(1,095,643)	(163,587)
Actual distributions	651,572	597,522
Benefit obligation, end of year	$ (10,998,523)	$ (9,984,154)

NOTE 13 – PENSION PLAN (CONTINUED)

Change in Plan Assets

	2011	2010
Plan assets at fair value at beginning of year	$ 8,207,493	$ 8,132,449
Actual return on plan assets	462,867	672,566
Actual employer contributions	-	-
Actual distributions	(651,572)	(597,522)
Plan assets, end of year	$ 8,018,788	$ 8,207,493
Unfunded pension obligation	$ (2,979,735)	$ (1,776,661)

Components of net periodic pension benefit cost:

	2011	2010
Service cost	$ -	$ 512
Interest cost	570,298	567,860
Expected return on plan assets	(472,092)	(470,343)
Amortization of net loss	527,584	410,020
Net period pension cost	$ 625,790	$ 508,049

The discount rate and expected rate of return on plan assets are critical assumptions which significantly affect pension accounting. Even relatively small changes in these rates would significantly change the recorded pension expense and accrued liability. Management believes the discount rate used in determining its year-end pension accounting is reasonable based on current available information. The expected rate of return on plan assets is determined by the plan assets' historical long-term returns by asset class. However, it is at least reasonably possible that these assumed rates will be revised in the near term, based on future events and changes in circumstances.

Weighted average assumptions used to determine the benefit obligation and net periodic benefit cost are as follows for the years ended December 31:

	2011	2010
Benefit obligation:		
Discount rate	5.00%	5.75%
Expected return on plan assets	6.00%	6.00%

	2011	2010
Net periodic benefit cost:		
Discount rate	5.00%	5.75%
Expected return on plan assets	6.00%	6.00%

Contributions

The Institute expects to make a contribution of $450,00 to the pension plan in fiscal year 2012.

NOTE 13 – PENSION PLAN (CONTINUED)

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid for the years ended December 31:

2012	$ 692,900
2013	702,700
2014	704,300
2015	717,800
2016	719,600
2017-2021	3,762,200
Total	$ 7,299,500

Plan Assets

The Plan's weighted average asset allocations by asset category are as follows at December 31:

	2011	2010
Fixed income mutual funds	99.30%	99.40%
Interest-bearing cash	0.70%	0.60%
Total	100.00%	100.00%

Effective November 2009, the Institute utilizes a target allocation of 100% fixed income. Barring any unforeseen market changes, the target allocation will not change significantly in the future.

The fair values of the Institute's pension plan assets at December 31, 2011, by asset category are as follows:

Mutual funds listed on a national market or exchange are valued at the last sales price, or if there is no sale and the market is still considered active, at the mean of the last bid and asked prices on such exchange. The Plan's interests in such investments are categorized as mutual funds. Such securities are classified within Level 1 of the valuation hierarchy.

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of December 31, 2011.

	Level 1	Level 2	Level 3	Total
Mutual funds	$ 8,018,788	$ -	$ -	$ 8,018,788
Total assets at fair value	$ 8,018,788	$ -	$ -	$ 8,018,788

NOTE 13 – PENSION PLAN (CONTINUED)

Defined Contribution Plan

In addition to the above defined benefit plan, the Institute sponsors a defined contribution 403(b) plan available to all full-time employees in which it matches 50% of participating employees' contributions up to 6% of eligible compensation. During 2011 and 2010, the Institute's share of contributions to this Plan was $76,987 and $71,910, respectively.

NOTE 14 – INCOME TAXES

The Institute and Foundation adopted the guidance for accounting for uncertainty in income taxes. Management has determined that the Institute has no material uncertain tax positions that would require recognition under the guidance. The federal and state income tax returns of the Institute for 2010, 2009 and 2008 are subject to examination by the IRS and state taxing authorities, generally for three years after they were filed.

NOTE 15 – CONCENTRATIONS

The Foundation received a significant amount of its donations from one donor in both 2011 and 2010, which comprised 18% and 43% of total contribution revenue for the years ended December 31, 2011 and 2010, respectively.

The Foundation has significant receivables outstanding from one donor at both December 31, 2011 and 2010, which comprised 51% and 61% of total contribution receivables at December 31, 2011 and 2010, respectively.

NOTE 16 – SUBSEQUENT EVENTS

Management evaluated subsequent events through March 30, 2012, the date the financial statements were available to be issued. Events or transactions occurring after December 31, 2011, but prior to March 30, 2012 that provided additional evidence about conditions that existed at December 31, 2011, have been recognized in the financial statements for the year ended December 31, 2011. Events or transactions that provided evidence about conditions that did not exist at December 31, 2011 but arose before the financial statements were available to be issued have not been recognized in the financial statements for the year ended December 31, 2011.