UNITED STATES NAVAL INSTITUTE AND AFFILIATE
Annapolis, Maryland

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

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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 financial statements of the United States Naval Institute and Affiliate (collectively known as the Institute), which comprise the consolidated statements of financial position as of December 31, 2013 and 2012, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Institute as of December 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

CliftonLarsonAllen LLP

Baltimore, Maryland
March 18, 2014

CONSOLIDATED FINANCIAL STATEMENTS

UNITED STATES NAVAL INSTITUTE AND AFFILIATE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
December 31, 2013 and 2012

	2013	2012
ASSETS		
ASSETS		
Cash	$ 1,257,254	$ 354,054
Accounts receivable, less allowance for doubtful accounts of $50,000 in 2013 and 2012	883,119	1,107,563
Contributions receivable, net	45,665	47,680
Inventory	2,153,717	2,384,388
Prepaid expenses and other assets	87,634	92,194
Investments, at fair value	6,612,952	6,259,731
Property and equipment, net	1,846,430	2,162,997
Deferred publishing costs	95,803	113,144
TOTAL ASSETS	$ 12,982,574	$ 12,521,751
LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable and accrued expenses	$ 1,108,225	$ 1,397,380
Deferred membership dues	2,864,446	2,799,814
Deferred subscriptions	513,019	548,418
Other deferred revenue	169,110	171,767
Charitable gift annuity payable	-	1,645
Unfunded pension obligation	1,990,533	4,022,872
Total liabilities	6,645,333	8,941,896
NET ASSETS		
Unrestricted	3,616,466	1,515,892
Temporarily restricted	1,652,673	995,861
Permanently restricted	1,068,102	1,068,102
Total net assets	6,337,241	3,579,855
TOTAL LIABILITIES AND NET ASSETS	$ 12,982,574	$ 12,521,751

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, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2013
REVENUES, INVESTMENT ACTIVITY, AND PUBLIC SUPPORT				
Publication sales	$ 4,717,440	$ -	$ -	$ 4,717,440
Membership dues and subscriptions	1,927,165	-	-	1,927,165
Contributions	1,090,176	1,126,831	-	2,217,007
Advertising	1,140,460	-	-	1,140,460
Conference income	516,056	-	-	516,056
Investment income	77,807	17,647	-	95,454
Net realized and unrealized gain on investments	799,366	211,782	-	1,011,148
Royalties	268,826	-	-	268,826
Other income	13,122	-	-	13,122
Net assets released from restrictions:				
Satisfaction of program and time restrictions	699,448	(699,448)	-	-
Total revenues, gains, and public support	11,249,866	656,812	-	11,906,678
EXPENSES				
Program services:				
Publishing costs	5,618,993	-	-	5,618,993
Conference expenses	349,725	-	-	349,725
Royalties	343,296	-	-	343,296
Special projects	59,695	-	-	59,695
Other	412,567	-	-	412,567
Total program services	6,784,276	-	-	6,784,276
Supporting services:				
Administrative costs	2,889,050	-	-	2,889,050
Fundraising expense	705,532	-	-	705,532
Membership development	374,773	-	-	374,773
Total supporting services	3,969,355	-	-	3,969,355
Total expenses	10,753,631	-	-	10,753,631
Change in net assets from operating activities	496,235	656,812	-	1,153,047
Nonoperating:				
Pension related changes other than net periodic pension costs	1,604,339	-	-	1,604,339
Change in net assets from nonoperating activities	1,604,339	-	-	1,604,339
CHANGES IN NET ASSETS	2,100,574	656,812	-	2,757,386
NET ASSETS, BEGINNING OF YEAR	1,515,892	995,861	1,068,102	3,579,855
NET ASSETS, END OF YEAR	$ 3,616,466	$ 1,652,673	$ 1,068,102	$ 6,337,241

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, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2012
REVENUES, INVESTMENT ACTIVITY, AND PUBLIC SUPPORT				
Publication sales	$ 4,881,980	$ -	$ -	$ 4,881,980
Membership dues and subscriptions	1,837,685	-	-	1,837,685
Contributions	687,247	355,772	50	1,043,069
Advertising	1,086,141	-	-	1,086,141
Conference income	476,094	-	-	476,094
Investment income	113,178	29,313	-	142,491
Net realized and unrealized gain on investments	731,104	171,736	-	902,840
Royalties	207,937	-	-	207,937
Other income	3,826	-	-	3,826
Net assets released from restrictions:				
Satisfaction of program and time restrictions	454,134	(454,134)	-	-
Total revenues, gains, and public support	10,479,326	102,687	50	10,582,063
EXPENSES				
Program services:				
Publishing costs	5,834,262	-	-	5,834,262
Conference expenses	340,609	-	-	340,609
Royalties	440,957	-	-	440,957
Special projects	34,591	-	-	34,591
Other	76,822	-	-	76,822
Total program services	6,727,241	-	-	6,727,241
Supporting services:				
Administrative costs	2,917,779	-	-	2,917,779
Fundraising expense	643,152	-	-	643,152
Membership development	594,867	-	-	594,867
Total supporting services	4,155,798	-	-	4,155,798
Total expenses	10,883,039	-	-	10,883,039
Change in net assets from operating activities	(403,713)	102,687	50	(300,976)
Nonoperating:				
Pension related changes other than net periodic pension costs	(1,343,137)	-	-	(1,343,137)
Change in net assets from nonoperating activities	(1,343,137)	-	-	(1,343,137)
CHANGES IN NET ASSETS	(1,746,850)	102,687	50	(1,644,113)
NET ASSETS, BEGINNING OF YEAR	3,262,742	893,174	1,068,052	5,223,968
NET ASSETS, END OF YEAR	$ 1,515,892	$ 995,861	$ 1,068,102	$ 3,579,855

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, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 2,757,386	$ (1,644,113)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	335,862	376,114
Increase (decrease) in inventory reserve	(32,000)	22,000
Increase (decrease) in allowance for doubtful accounts and contributions receivable	(725)	16,473
Net unrealized and realized gains on investments	(1,011,148)	(902,840)
Contributions - permanently restricted	-	(50)
Effects of changes in operating assets and liabilities:		
Accounts receivable	224,444	(205,530)
Contributions receivable	2,740	30,886
Inventory	262,671	(197,977)
Prepaid expenses and other assets	4,560	(9,073)
Deferred publishing costs	17,341	78,729
Accounts payable and accrued expenses	(289,155)	7,449
Deferred membership dues	64,632	(56,441)
Deferred subscriptions	(35,399)	(91,214)
Other deferred revenue	(2,657)	6,995
Unfunded pension obligation	(2,032,339)	1,043,137
Net cash provided by (used in) operating activities	266,213	(1,525,455)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(19,295)	(72,879)
Purchase of investments	(45,591)	(96,604)
Proceeds from sales and maturities of investments	703,518	1,708,543
Net cash provided by investing activities	638,632	1,539,060
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments to reduce long-term obligations	(1,645)	(9,076)
Permanently restricted contributions	-	50
Net cash used in financing activities	(1,645)	(9,026)
NET INCREASE IN CASH	903,200	4,579
CASH, BEGINNING OF YEAR	354,054	349,475
CASH, END OF YEAR	$ 1,257,254	$ 354,054

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 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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (continued)

as use in future periods or use for specified purposes. 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 benefit 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

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 $1,296,000 and $433,000 at December 31, 2013 and 2012, respectively.

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 expected to be 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, 2013 and 2012, 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 sales history.

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 or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 3 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 or depreciation 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 are 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 individual 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, 2013 and 2012.

The federal and state income tax returns for the Foundation for 2012, 2011, and 2010 are subject to examination by the IRS and state taxing authorities, generally for three years after they were filed.

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

Publication Sales
Revenue from the sale of publications is recognized at the time the sale occurs.

Advertising
Advertising revenues are recognized in the period when advertising is printed or placed in Institute publications. Amounts received in advance of printing are deferred as liabilities.

Contributions
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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred Revenue (continued)

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.

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:

	2013		2012	
	Cost	**Market**	**Cost**	**Market**
TIFF multi-asset fund	$ 4,831,411	$ 4,815,126	$ 5,067,190	$ 4,908,237
Corporate stock	765,546	1,769,216	765,546	1,322,942
Certificates of deposit	26,500	28,610	26,500	28,552
Total	$ 5,623,457	$ 6,612,952	$ 5,859,236	$ 6,259,731

NOTE 2 – INVESTMENTS (CONTINUED)

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

	2013	2012
Investment income	$ 95,454	$ 142,491
Realized/unrealized gains, net	1,011,148	902,840
Total	$ 1,106,602	$ 1,045,331

Investment income is net of management fees amounting to $5,626 and $8,673 in 2013 and 2012, respectively.

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.

NOTE 3 – FAIR VALUE MEASUREMENT (CONTINUED)

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, 2013 and 2012:

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.

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.

There were no unfunded commitments, and the redemption frequency and notice period were daily for the TIFF Multi-Asset fund for the years ended December 31, 2013 and 2012.

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 certificates of deposit consist of securities earning a fixed interest rate with a maturity of longer than three months. The certificates of deposit 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.

NOTE 3 – FAIR VALUE MEASUREMENT (CONTINUED)

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.

Below sets forth a table of assets and liabilities measured at fair value as of December 31, 2013 and 2012.

	2013			
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, 2013**
Corporate stock:				
Financial	$ 1,769,216	$ -	$ -	$ 1,769,216
Certificates of deposit	-	28,610	-	28,610
Mutual funds:				-
TIFF multi-asset fund	-	4,815,126	-	4,815,126
Total investment	1,769,216	4,843,736	-	6,612,952
Charitable gift annuity obligation	-	-	-	-
Total	$ 1,769,216	$ 4,843,736	$ -	$ 6,612,952

	2012			
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, 2012**
Corporate stock:				
Financial	$ 1,322,942	$ -	$ -	$ 1,322,942
Certificates of deposit	-	28,552	-	28,552
Mutual funds:				-
TIFF multi-asset fund	-	4,908,237	-	4,908,237
Total investment	1,322,942	4,936,789	-	6,259,731
Charitable gift annuity obligation	-	-	(1,645)	(1,645)
Total	$ 1,322,942	$ 4,936,789	$ (1,645)	$ 6,258,086

NOTE 3 – FAIR VALUE MEASUREMENT (CONTINUED)

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, 2013:

	Charitable Gift Annuity	
Assets at Fair Value Using Unobservable Inputs (Level 3)	**2013**	**2012**
Balance - January 1	$ (1,645)	$ (10,721)
Settlements	1,645	9,076
Balance - December 31	$ -	$ (1,645)

NOTE 4 – INVENTORY

Inventory consists of the following at December 31:

	2013	2012
Publications held for sale	$ 2,794,936	$ 3,004,907
Prepublication costs	60,525	109,847
Certificates	28,256	31,634
	2,883,717	3,146,388
Less allowance for obsolete inventory	730,000	762,000
Total	$ 2,153,717	$ 2,384,388

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following at December 31:

	2013	2012
Unconditional promises to give	$ 65,465	$ 68,205
Less allowance for uncollectible amounts	19,800	20,525
Net unconditional, promises to give	$ 45,665	$ 47,680
Amounts due in:		
Less than one year	$ 29,130	$ 37,095
One to five years	16,535	10,585
Total	$ 45,665	$ 47,680

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:

	2013	2012
Office facilities	$ 3,053,539	$ 3,053,539
Computer equipment and software	1,916,805	1,902,102
Furniture, fixtures and office equipment	560,795	556,203
Automobiles and warehouse equipment	41,343	41,343
	5,572,482	5,553,187
Less allowance depreciation and amortization	3,726,052	3,390,190
Total	$ 1,846,430	$ 2,162,997

Depreciation and amortization expense for the years ended December 31, 2013 and 2012 was $335,862 and $376,114, respectively.

NOTE 7 – FUTURE OBLIGATIONS

Charitable Gift Annuity

In 1995, the Institute received a cash contribution of $100,000 in the form of a charitable gift annuity. The liability under the agreement was recorded at the net present value of the estimated income owed to the donor based upon the donor's life expectancy and discounted using the risk-free rate. The donor passed away during 2013 and the liability as of December 31, 2013 is $0.

NOTE 8 – COMMITMENTS/CONTINGENCIES

Contract with Key Employees

The Institute has executed four 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 six months 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:

	2013	2012
Essay Contests	$ 496,513	$ 357,818
Technology	385,250	-
Naval Institute Press Subvention	335,890	358,848
Oral History	122,633	64,881
Photo Archives	121,274	21,752
Other	69,523	80,816
Conferences	60,925	48,541
Time restricted net assets	60,665	63,205
Total	$ 1,652,673	$ 995,861

NOTE 10 – PERMANENTLY RESTRICTED NET ASSETS

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

	2013	2012
General Program Support Endowments	$ 500,962	$ 500,962
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	$ 1,068,102	$ 1,068,102

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.

NOTE 11 – ENDOWMENT (CONTINUED)

Interpretation of Relevant Law (continued)

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

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, 2013 and 2012:

	2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ 500,174	$ 1,068,102	$ 1,568,276

	2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment funds	$ -	$ 307,375	$ 1,068,102	$ 1,375,477

NOTE 11 – ENDOWMENT (CONTINUED)

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

	2013			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets, beginning of year	$ -	$ 307,375	$ 1,068,102	$ 1,375,477
Investment return	-	192,799	-	192,799
Contributions	-	-	-	-
Total	$ -	$ 500,174	$ 1,068,102	$ 1,568,276

	2012			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets, beginning of year	$ -	$ 138,508	$ 1,068,052	$ 1,206,560
Investment return	-	168,867	-	168,867
Contributions	-	-	50	50
Total	$ -	$ 307,375	$ 1,068,102	$ 1,375,477

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.

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

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.

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 and fixed-income funds.

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

NOTE 13 – PENSION PLAN (CONTINUED)

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

	2013	2012
Benefit obligation, beginning of year	$ (12,148,409)	$ (10,998,523)
Interest cost	(495,917)	(541,308)
Actuarial loss	1,038,338	(1,245,426)
Actual distributions	642,269	636,848
Benefit obligation, end of year	$ (10,963,719)	$ (12,148,409)

Change in Plan Assets

	2013	2012
Plan assets at fair value at beginning of year	$ 8,125,537	$ 8,018,788
Actual return on plan assets	1,061,918	443,597
Actual employer contributions	428,000	300,000
Actual distributions	(642,269)	(636,848)
Plan assets at fair value at year end	$ 8,973,186	$ 8,125,537
Unfunded pension obligation	$ (1,990,533)	$ (4,022,872)

Components of net periodic pension benefit cost:

	2013	2012
Interest cost	$ 495,917	$ 541,308
Expected return on plan assets	(481,283)	(467,743)
Amortization of net loss	705,876	641,355
Net period pension cost	$ 720,510	$ 714,920

NOTE 13 – PENSION PLAN (CONTINUED)

Change in Plan Assets (continued)

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:

	2013	2012
Benefit obligation:		
Discount rate	5.00%	4.25%
Expected return on plan assets	6.00%	6.00%
Net periodic benefit cost:		
Discount rate	5.00%	4.25%
Expected return on plan assets	6.00%	6.00%

Contributions

The Institute expects to make a contribution of $547,000 to the pension plan in fiscal year 2014.

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:

2014	$ 678,000
2015	697,000
2016	704,000
2017	724,000
2018	753,000
2019-2022	3,864,000
Total	$ 7,420,000

NOTE 13 – PENSION PLAN (CONTINUED)

Plan Assets

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

	2013	2012
Fixed income mutual funds	33.1%	79.3%
Equity mutual funds	66.2%	20.0%
Interest-bearing cash	0.7%	0.7%
Total	100.0%	100.0%

Effective April 2013, the Institute, with the approval of the Board of Directors, utilizes a target allocation of 65% equities and 35% 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, 2013, 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, 2013.

	Level 1	Level 2	Level 3	Total
Mutual funds	$ 8,973,186	$ -	$ -	$ 8,973,186
Total assets at fair value	$ 8,973,186	$ -	$ -	$ 8,973,186

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 2013 and 2012, the Institute's share of contributions to this Plan was $81,806 and $80,524, 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 2012, 2011 and 2010 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 2013 and 2012, which comprised 27% and 19% of total contribution revenue for the years ended December 31, 2013 and 2012, respectively.

The Institute has significant receivables outstanding from one donor at both December 31, 2013 and 2012, which comprised 24% and 23% of total contribution receivables at December 31, 2013 and 2012, respectively.

NOTE 16 – SUBSEQUENT EVENTS

Management evaluated subsequent events through March 18, 2014, the date the financial statements were available to be issued. Events or transactions occurring after December 31, 2013, but prior to March 18, 2014 that provided additional evidence about conditions that existed at December 31, 2013, have been recognized in the financial statements for the year ended December 31, 2013. Events or transactions that provided evidence about conditions that did not exist at December 31, 2013 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, 2013.