**UNITED STATES NAVAL INSTITUTE AND AFFILIATE**
**Annapolis, Maryland**

**CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2014 and 2013**

**TABLE OF CONTENTS**


**INDEPENDENT AUDITORS' REPORT** ........ 1

**CONSOLIDATED FINANCIAL STATEMENTS** ........ 3

Consolidated Statements of Financial Position ........ 4
Consolidated Statements of Activities ........ 5
Consolidated Statements of Cash Flows ........ 7

Notes to Consolidated Financial Statements ........ 8

CliftonLarsonAllen LLP
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# Independent Auditors' 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, 2014 and 2013, 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, 2014 and 2013, 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 20, 2015

**CONSOLIDATED FINANCIAL STATEMENTS**

## UNITED STATES NAVAL INSTITUTE AND AFFILIATE
## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
## December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **ASSETS** | | |
| **ASSETS** | | |
| Cash | $ 1,050,180 | $ 1,257,254 |
| Accounts receivable, less allowance for doubtful accounts of $45,000 in 2014 and $50,000 in 2013 | 1,002,849 | 883,119 |
| Contributions receivable, net | 709,786 | 45,665 |
| Inventory | 1,991,640 | 2,153,717 |
| Prepaid expenses and other assets | 1,100,897 | 87,634 |
| Investments, at fair value | 7,155,771 | 6,612,952 |
| Property and equipment, net | 1,685,581 | 1,846,430 |
| Deferred publishing costs | 57,070 | 95,803 |
| **TOTAL ASSETS** | $ 14,753,774 | $ 12,982,574 |
| **LIABILITIES AND NET ASSETS** | | |
| **LIABILITIES** | | |
| Accounts payable and accrued expenses | $ 1,578,801 | $ 1,108,225 |
| Deferred membership dues | 2,854,718 | 2,864,446 |
| Deferred subscriptions | 493,594 | 513,019 |
| Other deferred revenue | 158,900 | 169,110 |
| Charitable gift annuity payable | - | - |
| Unfunded pension obligation | 2,864,486 | 1,990,533 |
| Total liabilities | 7,950,499 | 6,645,333 |
| **NET ASSETS** | | |
| Unrestricted | 3,458,460 | 3,616,466 |
| Temporarily restricted | 2,276,713 | 1,652,673 |
| Permanently restricted | 1,068,102 | 1,068,102 |
| Total net assets | 6,803,275 | 6,337,241 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 14,753,774 | $ 12,982,574 |

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

**UNITED STATES NAVAL INSTITUTE AND AFFILIATE**
**CONSOLIDATED STATEMENT OF ACTIVITIES**
**Year Ended December 31, 2014**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total 2014 |
|---|---|---|---|---|
| **REVENUES, INVESTMENT ACTIVITY, AND PUBLIC SUPPORT** | | | | |
| Publication sales | $ 5,565,548 | $ - | $ - | $ 5,565,548 |
| Membership dues and subscriptions | 2,081,361 | - | - | 2,081,361 |
| Contributions | 2,307,202 | 1,755,815 | - | 4,063,017 |
| Advertising | 1,031,933 | - | - | 1,031,933 |
| Conference income | 238,617 | - | - | 238,617 |
| Investment income | 74,004 | 12,851 | - | 86,855 |
| Net realized and unrealized gain on investments | (3,729) | 5,860 | - | 2,131 |
| Royalties | 270,305 | - | - | 270,305 |
| Other income | 9,221 | - | - | 9,221 |
| Net assets released from restrictions: | | | | |
| Satisfaction of program and time restrictions | 1,150,486 | (1,150,486) | - | - |
| Total revenues, gains, and public support | 12,724,948 | 624,040 | - | 13,348,988 |
| **EXPENSES** | | | | |
| Program services: | | | | |
| Publishing costs | 5,772,334 | - | - | 5,772,334 |
| Conference expenses | 318,716 | - | - | 318,716 |
| Royalties | 425,567 | - | - | 425,567 |
| Special projects | 241,552 | - | - | 241,552 |
| Other | 697,297 | - | - | 697,297 |
| Total program services | 7,455,466 | - | - | 7,455,466 |
| Supporting services: | | | | |
| Administrative costs | 2,732,007 | - | - | 2,732,007 |
| Fundraising expense | 770,699 | - | - | 770,699 |
| Membership development | 567,829 | - | - | 567,829 |
| Total supporting services | 4,070,535 | - | - | 4,070,535 |
| Total expenses | 11,526,001 | - | - | 11,526,001 |
| Change in net assets from operating activities | 1,198,947 | 624,040 | - | 1,822,987 |
| Nonoperating: | | | | |
| Pension related changes other than net periodic pension costs | (1,356,953) | - | - | (1,356,953) |
| Change in net assets from nonoperating activities | (1,356,953) | - | - | (1,356,953) |
| **CHANGES IN NET ASSETS** | (158,006) | 624,040 | - | 466,034 |
| **NET ASSETS, BEGINNING OF YEAR** | 3,616,466 | 1,652,673 | 1,068,102 | 6,337,241 |
| **NET ASSETS, END OF YEAR** | $ 3,458,460 | $ 2,276,713 | $ 1,068,102 | $ 6,803,275 |

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

**UNITED STATES NAVAL INSTITUTE AND AFFILIATE**
**CONSOLIDATED STATEMENT 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 CASH FLOWS**
**Years Ended December 31, 2014 and 2013**

| | 2014 | 2013 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Change in net assets | $ 466,034 | $ 2,757,386 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 288,182 | 335,862 |
| Increase (decrease) in inventory reserve | 78,000 | (32,000) |
| Increase (decrease) in allowance for doubtful accounts and contributions receivable | (8,790) | (725) |
| Net unrealized and realized gains on investments | (2,131) | (1,011,148) |
| Effects of changes in operating assets and liabilities: | | |
| Accounts receivable | (114,730) | 224,444 |
| Contributions receivable | (660,331) | 2,740 |
| Inventory | 84,077 | 262,671 |
| Prepaid expenses and other assets | (1,013,263) | 4,560 |
| Deferred publishing costs | 38,733 | 17,341 |
| Accounts payable and accrued expenses | 470,576 | (289,155) |
| Deferred membership dues | (9,728) | 64,632 |
| Deferred subscriptions | (19,425) | (35,399) |
| Other deferred revenue | (10,210) | (2,657) |
| Unfunded pension obligation | 873,953 | (2,032,339) |
| Net cash provided by operating activities | 460,947 | 266,213 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of property and equipment | (127,333) | (19,295) |
| Purchase of investments | (540,688) | (45,591) |
| Proceeds from sales and maturities of investments | - | 703,518 |
| Net cash provided by (used in) investing activities | (668,021) | 638,632 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Payments to reduce long-term obligations | - | (1,645) |
| **NET INCREASE (DECREASE) IN CASH** | (207,074) | 903,200 |
| **CASH, BEGINNING OF YEAR** | 1,257,254 | 354,054 |
| **CASH, END OF YEAR** | $ 1,050,180 | $ 1,257,254 |

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,

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (CONTINUED)

**Basis of Presentation** (continued)

such 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 $1,120,000 and $1,296,000 at December 31, 2014 and 2013, 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, 2014 and 2013, 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, 2014 and 2013.

The federal and state income tax returns for the Foundation for 2013, 2012, and 2011 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:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Cost** | **Market** | **Cost** | **Market** |
| TIFF multi-asset fund | $ 5,661,528 | $ 5,366,159 | $ 4,831,411 | $ 4,815,126 |
| Corporate stock | 765,546 | 1,750,973 | 765,546 | 1,769,216 |
| Certificates of deposit | 38,639 | 38,639 | 26,500 | 28,610 |
| **Total** | $ 6,465,713 | $ 7,155,771 | $ 5,623,457 | $ 6,612,952 |

**NOTE 2 – INVESTMENTS** (CONTINUED)

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

| | **2014** | **2013** |
|---|---|---|
| Investment income | $ 86,855 | $ 95,454 |
| Realized/unrealized gains, net | 2,131 | 1,011,148 |
| **Total** | $ 88,986 | $ 1,106,602 |

Investment income is net of management fees amounting to $5,115 and $5,626 in 2014 and 2013, 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, 2014 and 2013:

*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, 2014 and 2013.

*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.

Below sets forth a table of assets measured at fair value as of December 31, 2014 and 2013.

| | 2014 | | | |
|---|---|---|---|---|
| **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, 2014** |
| Corporate stock: | | | | |
| Financial | $ 1,750,973 | $ - | $ - | $ 1,750,973 |
| Certificates of deposit | - | 38,639 | - | 38,639 |
| Mutual funds: | | | | |
| TIFF multi-asset fund | - | 5,366,159 | - | 5,366,159 |
| **Total** | $ 1,750,973 | $ 5,404,798 | $ - | $ 7,155,771 |

| | 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** | $ 1,769,216 | $ 4,843,736 | $ - | $ 6,612,952 |

## NOTE 4 – INVENTORY

Inventory consists of the following at December 31:

| | 2014 | 2013 |
|---|---|---|
| Publications held for sale | $ 2,737,308 | $ 2,794,936 |
| Prepublication costs | 62,332 | 60,525 |
| Certificates | - | 28,256 |
| | 2,799,640 | 2,883,717 |
| Less allowance for obsolete inventory | 808,000 | 730,000 |
| **Total** | $ 1,991,640 | $ 2,153,717 |

## NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following at December 31:

| | 2014 | 2013 |
|---|---|---|
| Unconditional promises to give | $ 725,796 | $ 65,465 |
| Less allowance for uncollectible amounts | 16,010 | 19,800 |
| **Net unconditional promises to give** | $ 709,786 | $ 45,665 |
| Amounts due in: | | |
| Less than one year | $ 379,136 | $ 29,130 |
| One to five years | 330,650 | 16,535 |
| **Total** | $ 709,786 | $ 45,665 |

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:

| | 2014 | 2013 |
|---|---|---|
| Office facilities | $ 3,053,539 | $ 3,053,539 |
| Computer equipment and software | 1,985,026 | 1,916,805 |
| Furniture, fixtures and office equipment | 477,009 | 560,795 |
| Automobiles and warehouse equipment | 20,807 | 41,343 |
| | 5,536,381 | 5,572,482 |
| Less allowance for depreciation and amortization | 3,850,800 | 3,726,052 |
| **Total** | $ 1,685,581 | $ 1,846,430 |

Depreciation and amortization expense for the years ended December 31, 2014 and 2013 was $288,182 and $335,862, respectively.

## NOTE 7 – 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 8 – TEMPORARILY RESTRICTED NET ASSETS

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

| | 2014 | 2013 |
|---|---|---|
| Essay Contests | $ 619,033 | $ 496,513 |
| Naval Institute Press Subvention | 526,303 | 335,890 |
| Time restricted net assets | 417,396 | 60,665 |
| Technology | 262,235 | 385,250 |
| Oral History | 210,392 | 122,633 |
| Other | 165,768 | 69,523 |
| Conferences | 59,077 | 60,925 |
| Photo Archives | 16,509 | 121,274 |
| **Total** | $ 2,276,713 | $ 1,652,673 |

## NOTE 9 – PERMANENTLY RESTRICTED NET ASSETS

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

| | 2014 | 2013 |
|---|---|---|
| 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 10 – 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.

**NOTE 10 – ENDOWMENT** (CONTINUED)

### 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

### 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.

**NOTE 10 – ENDOWMENT** (CONTINUED)

Endowment Net Asset Composition by Type of Fund as of December 31:

| | 2014 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| Donor restricted endowment funds | $ - | $ 515,899 | $ 1,068,102 | $ 1,584,001 |

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

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

| | 2014 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| Endowment net assets, beginning of year | $ - | $ 500,174 | $ 1,068,102 | $ 1,568,276 |
| Investment return | - | 15,725 | - | 15,725 |
| Contributions | - | - | - | - |
| **Total** | $ - | $ 515,899 | $ 1,068,102 | $ 1,584,001 |

| | 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 |

## NOTE 11 – DESCRIPTION OF PROGRAM AND SUPPORTING SERVICES

The following programs 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.

### 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 12 – 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.

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

| | 2014 | 2013 |
|---|---|---|
| Benefit obligation, beginning of year | $ (10,963,719) | $ (12,148,409) |
| Interest cost | (539,553) | (495,917) |
| Actuarial loss | (1,283,625) | 1,038,338 |
| Actual distributions | 656,971 | 642,269 |
| **Benefit obligation, end of year** | $ (12,129,926) | $ (10,963,719) |

### Change in Plan Assets

| | 2014 | 2013 |
|---|---|---|
| Plan assets at fair value at beginning of year | $ 8,973,186 | $ 8,125,537 |
| Actual return on plan assets | 466,225 | 1,061,918 |
| Actual employer contributions | 483,000 | 428,000 |
| Actual distributions | (656,971) | (642,269) |
| **Plan assets at fair value at year end** | $ 9,265,440 | $ 8,973,186 |
| **Unfunded pension obligation** | $ (2,864,486) | $ (1,990,533) |

**NOTE 12 – PENSION PLAN** (CONTINUED)

Components of net periodic pension benefit cost:

| | 2014 | 2013 |
|---|---|---|
| Interest cost | $ 539,553 | $ 495,917 |
| Expected return on plan assets | (534,488) | (481,283) |
| Amortization of net loss | 318,120 | 705,876 |
| **Net period pension cost** | $ 323,185 | $ 720,510 |

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:

| | 2014 | 2013 |
|---|---|---|
| Benefit obligation: | | |
| Discount rate | 4.10% | 5.00% |
| Expected return on plan assets | 6.50% | 6.00% |
| Net periodic benefit cost: | | |
| Discount rate | 4.10% | 5.00% |
| Expected return on plan assets | 6.50% | 6.00% |

**Contributions**

The Institute expects to make a contribution of $485,000 to the pension plan in fiscal year 2015.

**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:

| | |
|---|---|
| 2015 | $ 729,000 |
| 2016 | 733,000 |
| 2017 | 748,000 |
| 2018 | 765,000 |
| 2019 | 781,000 |
| 2020-2024 | 3,916,000 |
| **Total** | $ 7,672,000 |

**NOTE 12 – PENSION PLAN** (CONTINUED)

**Plan Assets**

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

| | 2014 | 2013 |
|---|---|---|
| Fixed income mutual funds | 34.7% | 33.1% |
| Equity mutual funds | 64.7% | 66.2% |
| Interest-bearing cash | 0.6% | 0.7% |
| **Total** | 100.0% | 100.0% |

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, 2014, 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, 2014.

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Mutual funds | $ 9,265,440 | $ - | $ - | $ 9,265,440 |
| **Total assets at fair value** | $ 9,265,440 | $ - | $ - | $ 9,265,440 |

**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 2014 and 2013, the Institute's share of contributions to this Plan was $78,252 and $81,806, respectively.

## NOTE 13 – 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 2013, 2012 and 2011 are subject to examination by the IRS and state taxing authorities, generally for three years after they were filed.

## NOTE 14 – CONCENTRATIONS

The Foundation received a significant amount of its contributions from one donor in both 2014 and 2013. One donor's contributions comprised 22% and 27% of total contribution revenue for the years ended December 31, 2014 and 2013, respectively.

The Foundation also has significant receivables outstanding from one donor at December 31, 2014, which comprised 35% of total contribution receivables.

## NOTE 15 – SUBSEQUENT EVENTS

Management evaluated subsequent events through March 20, 2015, the date the financial statements were available to be issued. Events or transactions occurring after December 31, 2014, but prior to March 20, 2015 that provided additional evidence about conditions that existed at December 31, 2014, have been recognized in the financial statements for the year ended December 31, 2014. Events or transactions that provided evidence about conditions that did not exist at December 31, 2014 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, 2014.