

Report of Independent Auditors

**The Board of Directors
National Endowment for Democracy
Washington, DC**

We have audited the accompanying balance sheet of National Endowment for Democracy (the Endowment) as of September 30, 2011, and the related statements of activities and change in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Endowment's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Endowment's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Endowment as of September 30, 2011, and the change in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report, dated June 28, 2012, on our consideration of the Endowment's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.



Vienna, Virginia
June 28, 2012

Balance Sheet
September 30, 2011

| | <u>2011</u> |
|------------------------------------------|-----------------------------|
| Assets | |
| Cash And Cash Equivalents | \$ 3,346,819 |
| Investments | 651,304 |
| Grants Receivables | 88,961,980 |
| Other Receivables | 121,958 |
| Prepaid And Other Assets | 284,955 |
| Property And Equipment, net | <u>3,329,003</u> |
| Total assets | <u><u>\$ 96,696,019</u></u> |
| Liabilities And Net Assets | |
| Liabilities | |
| Accounts payable and accrued liabilities | \$ 1,775,961 |
| Grants payable | 89,229,720 |
| Refundable advances – Due to DOS | 1,851,799 |
| Deferred rent | <u>1,711,033</u> |
| Total liabilities | <u>94,568,513</u> |
| Net Assets | |
| Unrestricted | 1,120,606 |
| Temporarily restricted | <u>1,006,900</u> |
| Total net assets | <u>2,127,506</u> |
| Total liabilities and net assets | <u><u>\$ 96,696,019</u></u> |

See Notes To Financial Statements.

**Statement Of Activities And Change In Net Assets
Year Ended September 30, 2011**

| | 2011 | | |
|-----------------------------------------------------------------------------|---------------------|------------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Total |
| Support and revenue: | | | |
| Grant revenue – government agencies | \$ 134,943,294 | \$ - | \$134,943,294 |
| Other grants and contributions | - | 570,183 | 570,183 |
| Other revenue, interest, and miscellaneous income | 224,407 | - | 224,407 |
| Net assets released from restriction – satisfaction of program restrictions | 559,918 | (559,918) | - |
| Total support and revenue | <u>135,727,619</u> | <u>10,265</u> | <u>135,737,884</u> |
| Expenses: | | | |
| Program services: | | | |
| Federal grants programs | 113,013,151 | - | 113,013,151 |
| Other activities – federal | 4,130,297 | - | 4,130,297 |
| Other activities – non-federal | 511,016 | - | 511,016 |
| Total program services | <u>117,654,464</u> | <u>-</u> | <u>117,654,464</u> |
| Supporting services: | | | |
| Management and general | 17,919,267 | - | 17,919,267 |
| Total expenses | <u>135,573,731</u> | <u>-</u> | <u>135,573,731</u> |
| Change in net assets | 153,888 | 10,265 | 164,153 |
| Net assets: | | | |
| Beginning | 966,718 | 996,635 | 1,963,353 |
| Ending | <u>\$ 1,120,606</u> | <u>\$ 1,006,900</u> | <u>\$ 2,127,506</u> |

See Notes To Financial Statements.

Statement Of Cash Flows
Year Ended September 30, 2011

| | <u>2011</u> |
|---------------------------------------------------------------------------------------------|---------------------|
| Cash Flows From Operating Activities | |
| Change in net assets | \$ 164,153 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | |
| Depreciation and amortization | 695,564 |
| Realized and unrealized gain | (951) |
| Deferred rent | (1,036,325) |
| Changes in assets and liabilities: | |
| (Increase) decrease in: | |
| Grants receivable | 3,602,540 |
| Other receivables | 131,277 |
| Prepaid expenses | (151,271) |
| Increase (decrease) in: | |
| Accounts payable and accrued liabilities | 52,826 |
| Grants payable | (2,045,368) |
| Refundable advances – Due to DOS | 523,618 |
| Net cash provided by operating activities | <u>1,936,063</u> |
| Cash Flows From Investing Activities | |
| Purchases of property and equipment | (1,028,546) |
| Net cash used in investing activities | <u>(1,028,546)</u> |
| Net increase in cash and cash equivalents | 907,517 |
| Cash And Cash Equivalents | |
| Beginning | <u>2,439,302</u> |
| Ending | <u>\$ 3,346,819</u> |

See Notes To Financial Statements.

National Endowment for Democracy Notes to Financial Statements Year Ended September 30, 2011

NOTE 1. NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES

Nature of activities: The National Endowment for Democracy (the Endowment) is a private, not-for-profit organization headquartered in Washington, D.C. The establishment of the Endowment was followed by the National Endowment for Democracy Act (the Act) of the United States Congress which authorized the terms by which NED could receive an annual appropriation from Congress in the form of a grant awarded through the United States Information Agency (USIA). The purpose of the Endowment is to encourage free and democratic institutions throughout the world through activities that promote individual rights and freedoms. The Endowment awards grants to organizations with programs consistent with its objectives. On October 1, 1999, USIA and the US Department of State (USDOS) consolidated. Accordingly, the Endowment receives funding for its annual Congressional Appropriation and other special federal funding from the USDOS.

A summary of the Endowment's significant accounting policies follows:

Basis of accounting: The financial statements are prepared on the accrual basis of accounting, whereby, revenue is recognized when earned and expenses are recognized when incurred. The Endowment reports to the US Government on the basis of obligations incurred and cash expenditures made.

Basis of presentation: The Endowment is required to report 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. There were no permanently restricted net assets at September 30, 2011.

Cash and cash equivalents: For purposes of reporting cash flows, the Endowment considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Financial risk: The Endowment maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Endowment has not experienced any losses in such accounts. The Endowment believes it is not exposed to any significant financial risk on cash and cash equivalents.

The Endowment invests in mutual funds. Such investments are exposed to various risks such as market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to change in the value of such investments, it is at least reasonably possible that changes in risks in the near

term could materially affect investment balances and the amounts reported in the financial statements.

Investments: The Endowment's investments consist entirely of mutual funds and are reflected at fair market value. To adjust the carrying value of these investments, the change in fair market value is included as a component of investment income in the statement of activities and changes in net assets.

Fair value of financial instruments: The carrying amounts of the Endowment's financial instruments, including cash and cash equivalents, receivables, accounts payable and accrued expenses, approximate fair value because of the short maturity of these instruments.

Property and equipment: Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line methods over the estimated useful lives of the related assets, which range from three to ten years. The Endowment capitalizes all property and equipment purchased with a cost of \$5,000 or more.

Valuation of long-lived assets: The Endowment accounts for the valuation of long-lived assets under the *Impairment or Disposal of Long-Lived Assets Topic* of the Codification. This Topic requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. 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 estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Grants receivable: Grants receivables are due from the Department of State (DOS) and represent funds obligated by the Endowment to other organizations and administrative costs incurred by the Endowment. When the Endowment incurs expenses and when approves and obligates grant to the various organizations, a receivable from the Department of State (DOS) and a related grant payable is recorded. The Endowment collects US government funds by filing requests for direct funding and by presenting payment vouchers against letters of credit when it disburses cash for program grants and administrative costs. When payments are received from the awarding agency, the receivable is reduced. Management does not obligate any grants until the funding is approved and thus determined that there is no need for provision for doubtful accounts at September 30, 2011.

Grants payables: Grants payable represent the undischarged balances of funds obligated to the Endowment grantees. Grantee organizations are entitled to collect funds as needed in accordance with the terms of the grant agreement. Such grants payable are generally

disbursed within a 12-month period after the funds have been obligated to the Endowment's grantees.

Refundable advances –Due to DOS. Amount represents funds returned to the Endowment by grantees for grants that have been deobligated plus indirect rate amount that was charged.

Support and revenue: The Endowment receives grants from DOS and private grantors for various purposes. Grants received from DOS specify the periods in which monies are to be expended. Additionally, certain government grants restrict the use of funds for programs in specific countries. Revenue from government grants is recognized as earned in the year in which the Endowment obligates the funds for the intended purpose that is set forth in the grant agreement.

Agreements with DOS provide for the subsequent audit of costs funded under the grant agreements. It is the policy of the Endowment to provide for cost disallowances based upon its experience in previous grant audits. There was no provision for such disallowance for the year ended September 30, 2011.

Contributions: The Endowment reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified in the statement of activities and change in net assets as net assets released from restrictions. Income on these net assets is classified as temporarily restricted or unrestricted, in accordance with the donor's stipulation.

Use of estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the 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.

Income taxes: The Endowment is generally exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code. In addition, the Endowment qualifies for charitable contributions deductions and has been classified as an organization that is not a private foundation. Income which is not related to exempt purposes, less applicable deductions, is subject to federal and state corporate income taxes. There was no net tax liability for unrelated business income tax for the year ended September 30, 2011.

Management has evaluated the Endowment's tax positions and has concluded that the Endowment has taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of

whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. The Endowment files tax returns in the US federal jurisdictions. Generally, the Endowment is no longer subject to US federal or state and local income tax examinations by tax authorities for years before 2008.

Subsequent events: Subsequent events have been evaluated through June 28, 2012, which is the date the financial statements were available to be issued. This review and evaluation revealed no new material event or transaction that would require an additional adjustment to or disclosure in the accompanying financial statements.

NOTE 2. INVESTMENTS AND FAIR VALUE MEASUREMENTS

The Endowment's investments are measured at fair value and consist entirely of amounts invested in mutual funds.

The Fair Value Topic of the FASB Codification (the Codification) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and sets out a fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy are described below:

Level 1 – Quoted market prices in active markets for identical assets or liabilities

Level 2 – Observable market-based inputs or unobservable inputs corroborated by market data

Level 3 – Unobservable inputs that are not corroborated by market data

In determining the appropriate levels, the Endowment performs a detailed analysis of the assets and liabilities that are subject to accounting for fair value measurements. At each reporting period all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. There were no Level 3 inputs for any assets or liabilities held by the Endowment at September 30, 2011.

The Endowment's mutual funds are comprised of managed funds, with the underlying investments consisting of mainly corporate and US government bonds. The fair values of these investments have been estimated using net asset value (NAV) per share of the investment. The Endowment had no unfunded commitments to these investments. The Endowment is permitted to make redemptions at any time and amount and, therefore, these investments are considered a Level 2 item.

NOTE 3. PROPERTY AND EQUIPMENT

Property and equipment and accumulated depreciation at September 30, 2011, consist of the following:

| Asset category | Estimated Lives | Cost | Accumulated Depreciation | Net |
|---------------------------------|-----------------|--------------------|--------------------------|--------------------|
| Leasehold improvements | 2 – 10 years | \$4,997,464 | \$2,220,020 | \$2,777,444 |
| Furniture and fixtures | 3 – 7 years | 682,293 | 437,852 | 244,441 |
| Computer equipment and software | 3 – 5 years | 879,228 | 572,110 | 307,118 |
| | | <u>\$6,558,985</u> | <u>\$3,229,982</u> | <u>\$3,329,003</u> |

Depreciation expense for the year ended September 30, 2011 was \$695,564.

NOTE 4. GRANT REVENUE – GOVERNMENT AGENCIES

Grant revenue for the year ended September 30, 2011, consists of the following:

| | 2011 |
|---------------------------------------------------------------|----------------------|
| Total appropriations received from the US Department of State | <u>\$117,764,000</u> |
| Grants awarded/amended during the year | <u>\$18,907,183</u> |
| Revenue recognized | |
| Grants obligated, net of deobligations | \$113,013,151 |
| Other grant-related expenses | <u>21,930,143</u> |
| | <u>\$134,943,294</u> |

NOTE 5. EXPENSES

Program expenses for the year ended September 30, 2011, represent the following activities:

| | 2011 |
|--------------------------------------------------------|----------------------|
| Federal grant programs | <u>\$113,013,151</u> |
| Other activities – federal: | |
| International Forum: | |
| <i>Journal of Democracy</i> | 411,580 |
| Research and conferences | 193,119 |
| Management and support | 370,008 |
| Reagan/Fascell Fellowship Program | 1,063,812 |
| Democracy Resource Center | 496,703 |
| World Movement for Democracy | 722,345 |
| Center for International Media Assistance | 872,730 |
| | <u>4,130,297</u> |
| Other activities – non-federal: | |
| International Forum: | |
| Management and support | 5,112 |
| <i>Journal of Democracy</i> | 71,941 |
| Research and conferences | 42,459 |
| Assessing Democracy Assistance | 70,575 |
| World Movement for Democracy – Defending Civil Society | 192,568 |
| World Movement for Democracy | 69,863 |
| NED events and development | 58,498 |
| | <u>511,016</u> |
| | <u>\$117,654,464</u> |

NOTE 6. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes at September 30, 2011:

| | Balance at September 30, 2010 | Additions | Releases | Balance at September 30, 2011 |
|-------------------------------|----------------------------------|-------------------|---------------------|----------------------------------|
| NED events and development | \$634,283 | \$ 50,131 | \$ (72,923) | \$ 611,491 |
| World Movement for Democracy: | | | | |
| Hurford Youth | 1,400 | 1,000 | (2,400) | - |
| Canada Def. Civ. Soc. | 64,252 | 376,135 | (192,568) | 247,819 |
| Assessing Dem. Assist. | 74,039 | - | (70,575) | 3,464 |
| SIDA | 173,208 | - | (38,813) | 134,395 |
| International Forum: | | | | |
| <i>Journal of democracy</i> | - | 75,000 | (71,941) | 3,059 |
| Visiting Fellows Program | 551 | - | - | 551 |
| Research and conferences | - | 36,815 | (36,815) | - |
| UNDEF | 48,902 | - | (48,902) | - |
| Korea Foundation | - | 30,000 | (24,981) | 5,019 |
| 7th Assembly Youth Exchange | - | 1,102 | - | 1,102 |
| | <u>\$996,635</u> | <u>\$ 570,183</u> | <u>\$ (559,918)</u> | <u>\$ 1,006,900</u> |

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes specified by donors during the year ended September 30, 2011.

NOTE 7. BANK LETTER OF CREDIT

During fiscal year 2005, the Endowment obtained a standby letter of credit in the amount of \$377,323 from a commercial bank. The letter of credit represents the security deposit for the Endowment's noncancelable operating lease for office space. On October 22, 2010, the letter of credit was decreased to \$188,661, in accordance with the lease amendment.

NOTE 8. RELATED PARTIES

The Endowment awards grants to various organizations to be used for programs that the Board of Directors determines are consistent with the purposes of the NED Act. Some of the organizations that submit proposals and are awarded funds have members of their Boards of Directors represented on the Board of Directors of the Endowment. Article VI, Section V of the Endowment's bylaws provides that any Board member who is an officer or director of an organization seeking to receive grants from the Endowment must abstain from considering a voting on such grant. The provision does not prevent any director from supplying factual information that the Board requests.

NOTE 9. OPERATING LEASE

The Endowment has a noncancelable operating lease that was amended on October 31, 2010, to include additional space and an extension of the lease term to March 1, 2021. The lease for office space includes a provision for rent escalations. The lease expense is recognized on a straight-line basis ratably over the term of the lease. The difference between the straight-line expense and the required lease payment is reflected as deferred rent and lease incentive in the accompanying balance sheet.

| | |
|-------------|----------------------|
| 2012 | \$ 3,290,330 |
| 2013 | 3,378,595 |
| 2014 | 3,463,063 |
| 2015 | 3,549,639 |
| 2016 | 3,638,381 |
| 2017 – 2021 | 19,938,048 |
| | <u>\$ 37,258,056</u> |

Rent expense was \$1,725,804 for the year ended September 30, 2011.

NOTE 10. RETIREMENT PLAN

The Endowment has a defined contribution annuity plan for all of its employees, under which the Endowment contributes a percentage of eligible employees' annual earnings to individually-owned tax-deferred annuity contracts. The Endowment's contribution to the plan is based on 10% of an eligible employee's annual earnings. Employer contributions to the plan for the year ended September 30, 2011 were \$1,015,897.

NOTE 11. CONTINGENCY

Federal awards: The Endowment participates in a number of federally-assisted grant programs, which are subject to financial and compliance audits by the federal government or its representative. Management does not anticipate significant adjustments as a result of such an audit.

NOTE 12. CONCENTRATIONS OF REVENUE

During the year ended September 30, 2011, substantially all of the Endowment's revenue related to grants from the US Government.

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