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SUTRON CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2011, 2010 and 2009

1. ORGANIZATION AND BASIS OF PRESENTATION

Sutron Corporation ("Company") was incorporated on December 30, 1975, under the General Laws of the Commonwealth of Virginia. The Company is a leading provider of real-time data collection and control products, systems software and professional services in the hydrological, meteorological and oceanic monitoring markets. The Company's products include data loggers, satellite transmitters/loggers, sensors and system and application software. Customers consist of a diversified base of Federal, state, local and foreign government agencies, universities and hydropower companies.

The Company operates from its headquarters located in Sterling, Virginia. The Company has several branch offices located throughout the United States and a branch office in India. The Company has established a wholly-owned subsidiary, Sutron HydroMet Systems, Private Limited, which is located in New Delhi, India.

Basis of Presentation

The consolidated financial statements include the accounts of Sutron and its wholly-owned subsidiary, Sutron HydroMet Systems, Private Ltd. All intercompany balances and transactions have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

Revenue for the Company's products, consisting of both equipment and software, is recognized upon shipment, delivery, installation or customer acceptance of the product, as agreed in the customer order or contract. Sutron does sell its software products without the related equipment although software products are integral to systems. The Company's typical system requires no significant production, modification or customization of the software or hardware. For complex systems, revenue is deferred until customer acceptance. The Company does provide customer discounts and does allow for product returns. The Company does not do consignment sales or bill and hold arrangements. Revenue reflects reductions due to discounts and product returns. Product returns have historically been insignificant in amount.

The Company's sales arrangements for systems often include services in addition to equipment and software. These services could include equipment integration, software customization, installation, maintenance, training, and customer support. For sales arrangements that include bundled hardware, software and services, Sutron accounts for any undelivered service offering as a separate element of a multiple-element arrangement. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product or service when it is sold separately. Revenue for these services is typically recognized ratably over the period benefited or when the services are complete.

The Company uses the percentage of completion method for recognizing revenue and profits when it performs on fixed price contracts that extend over a number of years. Under the percentage of completion method, revenue and profits are recorded as costs are incurred based on estimates of total sales value and costs at completion where total profit can be estimated with reasonable accuracy and ultimate realization is reasonably assured. Profit estimates are revised periodically based upon changes and facts, and any losses on contracts are recognized immediately. Contracts may contain provisions to earn incentive and award fees if targets are achieved. Incentive and award fees that can be reasonably estimated are recorded over the performance period of the contract. Incentive and award fees that cannot be reasonably estimated are recorded when awarded. The Company recognizes revenue from time-and-materials contracts to the extent of billable rates, times hours delivered, plus direct materials costs incurred. Some of the contracts include provisions to withhold a portion of the contract value as retainage. The Company's policy is to take into revenue the full value of the contract, including any retainage, as it performs against the contract. Contract costs include allocated indirect costs. Anticipated losses on all contracts are recognized as soon as they become known. Costs on contracts in excess of related billings are reflected as unbilled receivables and are included in accounts receivable. Billings in excess of costs are reflected as a liability.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash equivalents include time deposits and all highly liquid debt instruments with original maturities of three months or less. Interest paid approximated $900, $26,000 and $0 for the years ended December 31, 2011, 2010 and 2009. Income taxes paid approximated $706,000, $1,332,000 and $630,000 for the years ended December 31, 2011, 2010 and 2009, respectively. Foreign income tax paid approximated $33,000, $336,000 and $144,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

Restricted Cash

For the years ended December 31, 2011 and 2010, the Company had submitted bid bonds or performance bonds on both official tenders or awarded contracts. At December 31, 2011 and 2010, cash in the amount of $760,037 and $796,189, respectively, was restricted for bid or performance bonds.

Accounts Receivable

Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for utilizing the allowance method. At December 31, 2011 and 2010, the Company's investment in accounts 90 days or more past due was $1,398,668 and $584,832, respectively, net of contract retainages. Bad debt expense for the years ending December 31, 2011, 2010, and 2009 was $44,000, $0 and $34,539, respectively.

Inventory

Inventory is stated at the lower of cost or market. Electronic components costs, work in process and finished goods costs consist of materials, labor and overhead and are recorded at a standard cost that approximates the average cost method. The Company provides allowances on inventories for any material that has become obsolete or may become unsellable based on estimates of future demand and sale price in the market.

Property and Equipment

Property and equipment is recorded at cost and depreciated over their estimated useful lives, ranging from three to ten years, using the straight-line method for financial statement purposes, and the straight-line and accelerated methods for income tax purposes. Expenditures for maintenance, repairs, and improvements that do not materially extend the useful lives of the assets are charged to earnings as incurred. When items of property and equipment are disposed of, the cost of the asset and the related accumulated depreciation are removed from the accounts. Any gain or loss resulting from the removal from service is taken into the current period earnings.

Acquisition and Goodwill

On December 31, 2009, the Company purchased the assets of Ilex Engineering, Inc., a provider of DOMSAT systems, custom software and engineering services, located in Columbia, Maryland. The acquisition has strengthened the Company's position in the GOES data collection services market and global satellite market. The purchase price of approximately $575,000 was allocated among tangible assets based on the relative fair market value of assets. The excess of the purchase price over the fair value of assets in the amount of approximately $570,000 was recorded as goodwill and the entire amount is expected to be deductible for tax purposes.

Goodwill represents the excess of cost of the acquired net assets over the net amounts assigned to assets acquired and liabilities assumed. Goodwill is not amortized, but rather evaluated for impairment each year. Impairment exists when the carrying amount of goodwill exceeds its implied fair value. The Company performs impairment testing in the last quarter of each year. No impairment of goodwill was deemed to exist as of the balance sheet date.

Income Taxes

The Company utilizes an asset and liability approach to accounting for income taxes. The objective is to recognize the amount of income taxes payable or refundable in the current year based on the Company's income tax return and the deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The asset and liability method accounts for deferred income taxes by applying enacted statutory rates to temporary differences, the difference between financial statement amounts and tax basis of assets and liabilities. The resulting deferred tax liabilities or assets are classified as current or noncurrent based on the classification of the related asset or liability. Deferred income tax liabilities or assets are adjusted to reflect changes in tax laws or rates in the year of enactment.

Management has evaluated the Company's tax positions and concluded that the Company had taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance. With few exceptions, the Company is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2008.

Capital

The Company has 12,000,000, $.01 par value, shares of authorized common stock. There were 4,704,632 shares issued and outstanding at December 31, 2011 and 4,575,632 shares issued and outstanding at December 31, 2010.

Foreign Currency Translation

Results of operations for the Company's foreign branch office and foreign wholly-owned subsidiary are translated from the designated functional currency to the U.S. dollar using average exchange rates during the period, while assets and liabilities of the foreign branch office are translated at the exchange rate in effect at the reporting date. Resulting gains or losses from translating foreign currency financial statements are included in accumulated other comprehensive loss, net of any related tax effect.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 vary from the estimates that were used.

Earnings per Share

The Company has adopted the provision of FASB ASC 260 that establishes standards for computing and presenting earnings per share (EPS) for entities with publicly held common stock. The standard requires presentation of two categories of earnings per share, basic EPS and diluted EPS. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the year. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

Stock Compensation Plans

Effective January 1, 2006, the Company adopted the provisions of FASB ASC 718 Compensation – Stock Compensation, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. Additionally, the Company follows the Securities and Exchange Commission's Staff Accounting Bulletin Share-Based Payment which provides supplemental application guidance based on the views of the SEC.

Fair Value Measurement

Accounting standards establish a framework for measuring fair value. That 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) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy under the standards are described as follows:

Level 1 – Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities or other inputs observable for the asset or liability, either directly or indirectly through corroboration with observable market data. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

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.

For the fiscal years ended December 31, 2011 and 2010, the application of valuation techniques applied to similar assets and liabilities has been consistent. The following is a description of the valuation methodologies used for instruments measured at fair value:

Certificates of Deposit

Certificates of deposit are carried at cost, which approximates fair value based upon observable market prices of similar instruments. If observable market prices are not available, fair values are estimated by discounting expected future cash flows applying interest rates currently being offered. For the fiscal years ended December 31, 2011, and 2010, all certificates of deposit are valued using Level 2 inputs and are valued at $924,294 and $919,130, respectively.

The carrying amounts of the Company’s financial instruments not described above arise in the ordinary course of business and approximate fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Reclassifications

Certain items on the Balance Sheet as of December 31, 2010 have been reclassified with no effect on net income or earnings per share to be consistent with the classifications adopted as of December 31, 2011.

Recent Accounting Pronouncements

The FASB issued ASU No. 2009-13, Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force. This ASU addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The ASU is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after September 15, 2010. The adoption of the new guidance did not have a material impact on the Company’s consolidated financial statements.

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The FASB issued ASU No. 2009-14, Software (Topic 985) – Certain Revenue Arrangements That Include Software Elements – a consensus of the FASB Emerging Issues Task Force. The amendments in this ASU change the accounting model for revenue arrangements that include both tangible products and software elements. The ASU is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after September 15, 2010. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-28, "Intangible – Goodwill and Other (Topic 350) – When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-29, "Business Combinations (Topic 805) – Disclosure of Supplementary Pro Forma Information for Business Combinations." The guidance requires pro forma disclosure for business combinations that occurred in the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma information should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

The Securities Exchange Commission (SEC) issued Final Rule No. 33-9002, "Interactive Data to Improve Financial Reporting." The rule requires companies to submit financial statements in extensible business reporting language (XBRL) format with their SEC filings on a phased-in schedule. Large accelerated filers and foreign large accelerated filers using U.S. generally accepted accounting principles (GAAP) were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2010. All remaining filers were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2011. The Company has submitted financial statements in extensible business reporting language (XBRL) format with their SEC filings in accordance with the phased-in schedule.

In March 2011, the SEC issued Staff Accounting Bulletin (SAB) 114. This SAB revises or rescinds portions of the interpretive guidance included in the codification of the Staff Accounting Bulletin Series. This update is intended to make the relevant interpretive guidance consistent with current authoritative accounting guidance issued as a part of the FASB's Codification. The principal changes involve revision or removal of accounting guidance references and other conforming changes to ensure consistency of referencing through the SAB Series. The effective date for SAB 114 is March 28, 2011. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU is the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application is not permitted. The Company is currently assessing the impact that ASU 2011-04 will have on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220) – Presentation of Comprehensive Income." The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single statement of comprehensive income should include the components of net income, a total for net income, the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present all the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. The amendments do not require transition disclosures. The Company is currently assessing the impact that ASU 2011-05 will have on its consolidated financial statements.

In August 2011, the SEC issued Final Rule No. 33-9250, "Technical Amendments to Commission Rules and Forms related to the FASB's Accounting Standards Codification." The SEC has adopted technical amendments to various rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. These revisions were necessary to conform those rules and forms to the FASB Accounting Standards Codification. The technical amendments include revision of certain rules in Regulation S-X, certain items in Regulation S-K, and various rules and forms prescribed under the Securities Act, Exchange Act and Investment Company Act. The Release was effective as of August 12, 2011. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, "Intangible – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment." The amendments in this ASU permit an entity to first assess qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company is currently assessing the impact that ASU 2011-08 will have on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, “Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities.” This ASU requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company is currently assessing the impact that ASU 2011-11 will have on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company is currently assessing the impact that ASU 2011-12 will have on its consolidated financial statements.

3. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, consists of the following:

		2011		2010
Trade receivables	$	5,598,124	$	4,165,239
Unbilled receivables		638,950		804,618
Contract retainage		602,360		452,118
Allowance for doubtful accounts		(85,000)		(41,000)
Totals	$	6,754,434	$	5,380,975

4. INVENTORY

Inventory consists of the following at December 31:

		2011		2010
Electronic components	$	2,078,432	$	2,237,257
Work in process		1,446,419		1,493,664
Finished goods		662,859		751,834
Allowance for obsolete inventory		(667,180)		(724,053)
Totals	$	3,520,530	$	3,758,702

5. PROPERTY AND EQUIPMENT

A summary of property and equipment at December 31 is as follows:

		2011		2010
Furniture, fixtures and equipment	$	1,915,375	$	1,847,377
Vehicles		253,176		278,121
Leasehold improvements		1,555,057		1,555,057
Totals	$	3,723,608	$	3,680,555

Accumulated depreciation and amortization at December 31, is as follows:

		2011		2010
Furniture, fixtures and equipment	$	1,554,629	$	1,445,985

Vehicles		232,527		272,530
Leasehold improvements		411,572		255,069
Totals	$	2,198,728	$	1,973,584
Property and Equipment, Net	$	1,524,880	$	1,706,971

Depreciation and amortization expense totaled $267,741, $277,868 and $247,311 for the years ended December 31, 2011, 2010 and 2009, respectively.

6. CONTRACTS IN PROGRESS

A summary of contracts in progress at December 31 is as follows:

	2011	2010
Costs incurred to date	$ 4,158,690	$ 2,570,022
Estimated earnings	1,957,728	971,684
Revenue recognized to date	6,116,418	3,541,706
Billings to date	(5,678,483)	(3,098,788)
	$ 437,935	$ 442,919
Included in the accompanying balance sheets:		
Costs in excess of billings on uncompleted contracts (unbilled receivables)	$ 638,950	$ 804,618
Billings in excess of costs on uncompleted contracts	(201,015)	(361,699)
	$ 437,935	$ 442,919

7. LINE OF CREDIT

The Company has a $3,000,000 line of credit with a commercial bank. The line of credit is collateralized by substantially all of the assets of the Company and expires September 5, 2013. Under the terms of the line of credit, the Company is required to maintain certain financial covenants. Interest is charged at the bank's prime rate and is payable monthly. There was no balance outstanding at December 31, 2011 and 2010.

The Company frequently bids on and enters into international contracts that require bid and performance bonds. At December 31, 2011 and 2010, the commercial bank had issued standby letters of credit on behalf of the Company in the amount of $898,013 and $1,583,000, respectively that served as either bid or performance bonds. The amount available under the line of credit was reduced by this amount.

8. OTHER ACCRUED EXPENSES

Components of other accrued expenses consist of the following at December 31:

	2011	2010
Accrued vacation pay	$ 264,260	$ 251,124
Accrued warranty costs	270,000	311,000
Customer advance payments	781,896	808,762
Other accruals	257,253	172,200
Totals	$ 1,573,409	$ 1,543,086

9. ACCRUED WARRANTY COSTS

The Company warranties its products for up to two years and estimated warranty costs are based upon management's best estimate of the amounts necessary to settle future and existing claims on equipment sold as of the balance sheet date. Factors considered include actual past experience of product returns and the related estimated cost of labor and material to make the necessary repairs as well as technological advances and enhanced design and manufacturing processes. If actual future product return rates or the actual costs of material and labor differ from the estimates, adjustments to the accrued warranty liability are made. Changes to the product warranty reserve are identified below and represent adjustments to the reserve based on management estimates and other factors as noted above:

Balance as of December 31, 2008	$245,000
Reserve adjustment	59,000
Balance as of December 31, 2009	304,000
Reserve adjustment	7,000
Balance as of December 31, 2010	311,000
Reserve adjustment	(41,000)
Balance as of December 31, 2011	$270,000

10. NOTES PAYABLE

The Company did not have any Notes payable outstanding at December 31, 2011 and 2010.

11. LEASE OBLIGATIONS

The Company entered into a ten-year lease for a new corporate headquarters and operations facility in Sterling, Virginia on November 13, 2008. The Company moved into the new facility on May 15, 2009 and lease payments commenced on June 1, 2009. As per the lease agreement, the monthly rent for the first year was $30,135, and increases 3 percent per annum. The Company leased additional space in its Sterling facility on October 4, 2010 resulting in additional monthly rent of $3,119 and with the same expiration date as the original lease. The lease agreement includes additional rent payments based on a pro rata portion of operating expenses which consist of building insurance, real estate taxes, landscaping and other property related expenses. The Company received a tenant improvement allowance in the amount of $1,390,850 from the landlord. The tenant improvement allowance was capitalized and recorded as an asset under leasehold improvements and as a liability under deferred rent.

The Company leases office and warehouse space in West Palm Beach, Florida. The one year lease, expiring December 31, 2012, requires monthly payments of $3,044. The Company's wholly owned subsidiary, Sutron Hydromet Systems, Pvt., Ltd., leases office space and furniture in New Delhi, India. The three-year lease expires in August 2012 and requires monthly payments of $1,821.

The following is a schedule of future minimum lease payments by year:

Years ending December 31:		
2012	$	457,110
2013		431,079
2014		441,874
2015		452,981
2016		464,380
2017 and thereafter		1,169,638
Total	$	3,417,062

Rent expense amounted to $410,773, $453,589 and $385,375 for the years ended December 31, 2011, 2010 and 2009, respectively.

12. INCOME TAXES

The income tax expense charged to operations for the years ended December 31, were as follows:

		2011		2010		2009
Domestic income tax expense	$	711,000	$	1,473,000	$	1,110,000
Foreign income tax expense		33,000		121,000		144,000

Deferred tax (benefit) expense		(34,000	)		(114,000	)		65,000
Total income tax expense	$	710,000		$	1,480,000		$	1,319,000

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Deferred tax assets, are comprised of the following at December 31:

	2011	2010	2009
Accrued vacation and warranty	$ 208,000	$ 219,000	$ 80,000
Stock compensation additional paid in capital	160,000	163,000	131,000
Accounts receivable and inventory allowances	113,000	95,000	201,000
Gross deferred tax assets	481,000	477,000	412,000
Gross deferred tax liability – depreciation	(69,000)	(99,000)	(148,000)
Net deferred tax assets	$ 412,000	$ 378,000	$ 264,000

The realization of the deferred tax assets is dependent on future taxable earnings. The Company has not provided for a deferred tax asset valuation allowance due to their current and anticipated future earnings.

Reconciliation of the amount of reported income tax expense and the amount computed by multiplying the applicable statutory Federal income tax rate is as follows:

	2011	2010	2009
Income before income taxes	$ 2,230,674	$ 4,467,392	$ 3,547,601
Applicable statutory tax rate	34%	34%	34%
Computed "expected" Federal income tax expense	758,000	1,519,000	1,206,000
Adjustments to Federal income tax resulting from:			
State income tax expense	99,000	267,000	206,000
Tax credits and other	(147,000)	(306,000)	(93,000)
Income tax expense	$ 710,000	$ 1,480,000	$ 1,319,000

13. MAJOR CUSTOMERS

Net sales for the years ended December 31, 2011, 2010 and 2009, include sales to the following major customers, together with the receivables due from the major customers:

	Net Sales Year Ended December 31,			% to Total Net Sales Year Ended December 31,		
	2011	2010	2009	2011	2010	2009
U.S. Government Agencies	$ 6,890,444	$ 8,291,418	$ 7,337,768	34%	36%	35%
Ministry of Energy and Water, Afghanistan	2,268,219	686,133	982,286	11%	3%	5%
Dominion/ADASA	1,159,686	1,880,323	2,317,998	6%	8%	11%
Tamil Nadu Agricultural University	131,778	372,982	2,357,331	1%	2%	11%
	$ 10,450,127	$ 11,230,856	$ 12,995,383	52%	49%	62%

	Accounts Receivable Amount at December 31,			% of Total Accounts Receivable at December 31,		
	2011	2010	2009	2011	2010	2010
U.S. Government Agencies	$ 1,460,810	$ 1,183,509	$ 1,315,195	22%	22%	18%
Ministry of Energy and Water, Afghanistan	1,447,536	577,035	593,841	21%	11%	8%
Dominion/ADASA	563,487	49,151	2,108,081	8%	1%	28%
Tamil Nadu Agricultural University	12,398	144,632	1,461,170	—	3%	20%
	$ 3,184,231	$ 1,954,327	$ 5,478,287	51%	37%	74%

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The above table includes unbilled accounts receivable. As of December 31, 2011 and 2010, unbilled receivables of $460,000 and $751,000 are included for Ministry of Energy and Water, Afghanistan. As of December 31, 2009, unbilled receivables of $1,068,000 and $1,040,000 are included for Dominion/ASDA and Tamil Nadu Agricultural University, respectively.

Because of the nature of the Company's business, the major customers may vary between years.

14. CONCENTRATIONS

The Company's bank participates in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2011, all non-interest bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage is in addition to, and separate from, the coverage available under the FDIC's general deposit insurance rules. The Company also maintains accounts that are not covered by the guarantee program. At times throughout the year, cash and cash equivalents exceeded the FDIC insurance limits in these accounts. As of December 31, 2011 and 2010, the Company's cash deposits exceeded the FDIC insured amount by approximately $9,665,000 and $8,550,000, respectively.

The Company's products use certain standard and application specific components that are acquired from one or a limited number of sources. The Company has generally been able to procure adequate supplies of these components in a timely manner from existing sources. The Company's inability to obtain a sufficient quantity of components when required or to develop alternative sources at acceptable prices and within a reasonable time, could result in delays or reductions in product shipments which could materially affect the Company's operating results in any given period.

15. STOCK OPTIONS

The Company's Amended and Restated 1996, 1997 and 2002 Stock Option Plans (the "Stock Option Plans") provide for the issuance of non-qualified stock options to employees, officers and directors. The Company's 2010 Equity Incentive Plan provides for the grant of stock options, stock appreciation rights, restricted stock, stock units, unrestricted stock, dividend equivalent rights and cash awards. All plans are administered by the compensation committee of the Board of Directors who select persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award.

The Company has granted stock options under the Stock Option Plans to key employees and directors for valuable services provided to the Company. Under the 1996 Plan, the Company authorized 260,000 shares, 259,000 of which have been granted. The Company authorized 60,000 shares under the 1997 Plan, all of which have been granted. Under the 2002 Stock Option Plan, the Company authorized 650,000 shares, 599,059 of which have been granted. The 1996, 1997 and 2002 Plans remain in effect until such time as no shares of Stock remain available for issuance under the Plans and the Company and Optionees have no further rights or obligations under the Plans. Under the 2010 Equity Incentive Plan, the Company authorized 500,000 shares, none of which have been granted. The ability to make awards under the 2010 Plan will terminate in May 2020. Shares under all of the plans may be granted at not less than 100 percent of the fair market value at the grant date. All options have a ten-year term from the date of grant. Cancelled or expired options are able to be reissued.

The Company measures and recognizes compensation expense for all stock-based payments at fair value. The Company recognizes stock-based compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. In fiscal year 2011, the Company awarded 18,559 shares of common stock to board members as performance and incentive awards. The awards vest over a period of one year. Stock based compensation expense relating to stock option awards for the years ended December 31, 2011, 2010 and 2009 was $103,216, $81,175 and, $132,663, respectively. These expenses were included in the selling, general and administrative lines of the Consolidated Statements of Operations. Unamortized stock compensation expense as of December 31, 2011 totaled approximately $74,000 and these costs will be expensed over a weighted average period of 2 years. The weighted average fair value of options granted during the years ended December 31, 2011, 2010 and 2009 were calculated using the Black-Scholes option pricing model.

The Black-Scholes model estimates the per share fair value of an option on its date of grant based on the option's exercise price; the price of the underlying stock on the date of grant; the estimated dividend yield; a "risk-free" interest rate; the estimated option term; and the expected volatility. For the "risk-free" interest rate, the Company uses a United States Treasury Bond due in the number of years equal to the option's expected term. The estimated option term is based upon the contractual term of the option. To determine expected volatility, the Company analyzes the historical volatility of its stock. The valuation assumptions used are shown below:

	2011	2010	2009
Risk free rate	2.66-3.19%	3.36%	2.46-3.11%
Expected volatility	39%	17%	25-33%
Dividend yield	0%	0%	0%
Expected term in years	10	10	10

The following table summarizes stock option activity under the Stock Option Plans for the last three years:

2011

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at beginning of period	634,252	$2.37	3.59	$2,747,390
Granted	18,559	6.86	—	—
Exercised	129,000	.99	—	529,095
Forfeited or expired	30,833	6.94	—	—
Outstanding at end of period	492,978	$2.61	2.93	$1,925,176
Exercisable at end of period	446,908	$2.20	2.42	$1,925,176
Nonvested at end of period	46,070	$6.62	7.88	$—

2010

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at beginning of period	589,252	$2.01	4.08	$3,071,261
Granted	50,000	6.47	—	—
Exercised	5,000	0.68	—	30,725
Forfeited or expired	—	—	—	—
Outstanding at end of period	634,252	$2.37	3.59	$2,747,390
Exercisable at end of period	573,582	$1.92	3.09	$2,741,701
Nonvested at end of period	60,670	$6.61	8.32	$5,690

2009

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at beginning of period	544,252	$1.80	4.66	$1,709,610

Granted	45,000	4.57	—	—
Exercised	—	—	—	—
Forfeited or expired	—	—	—	—
Outstanding at end of period	589,252	$2.01	4.08	$3,071,261
Exercisable at end of period	553,828	$1.71	3.86	$3,049,706
Nonvested at end of period	35,424	$6.58	7.50	$21,555

16. EARNINGS PER SHARE

The following table shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of potential dilutive common stock.

	Twelve Months Ended December 31,					
		2011		2010		2009
Net income	$	1,520,674	$	2,987,392	$	2,228,601
Shares used in calculation of income per share:						
Basic		4,619,542		4,573,810		4,570,632
Effect of dilutive options		301,752		421,331		404,480
Diluted		4,921,294		4,995,141		4,975,112
Net income per share:						
Basic	$	0.33	$	0.65	$	0.49
Diluted	$	0.31	$	0.60	$	0.45

Stock options that could potentially dilute basic EPS in the future were not included in the computation of diluted EPS, because to do so would have been anti-dilutive, were 138,000, 45,000 and 96,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

17. PROFIT SHARING PLAN

The Company has a 401(k) Profit-Sharing Plan that covers substantially all employees of the Company. The 401(k) provision permits employees to elect to defer a portion of their compensation. The Plan was amended in July 2010 to allow for employer matching of up to 5 percent. The profit-sharing contribution is determined each year by the Board of Directors based on profits. The Company did not make a profit sharing contribution for the years ended December 31, 2011, 2010 and 2009. The employer matching contribution was approximately $240,000, $201,000 and $158,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

18. SEGMENT INFORMATION

The Company operates principally in two industry segments: the manufacturing of standard products consisting of hydrological, meteorological and oceanic monitoring and control products which are sold off-the-shelf and systems that are comprised of standard products and custom items as required by the system specification also including software and services including installation, training, and maintenance of systems. Corporate assets consisted mainly of cash, prepaid expenses, deferred taxes, and income tax receivables. The results of these segments are shown below (in thousands):

	Years Ended Dec. 31	Net Sales	Operating Income (Loss)	Total Assets	Depreciation	Capital Expenditures
Standard Products	2011	9,023	1,166	6,021	147	36
	2010	12,944	2,866	5,802	95	29
	2009	11,791	1,959	5,698	139	283
Systems/Services	2011	11,199	963	6,502	121	51
	2010	10,032	1,551	5,284	183	71
	2009	9,060	1,374	6,477	108	103
Corporate and Unallocated	2011	—	—	11,560	—	—
	2010	—	—	11,901	—	—
	2009	—	—	7,353	—	—
Total Company	2011	20,222	2,129	24,083	268	87
	2010	22,976	4,417	22,907	278	100
	2009	20,851	3,333	19,528	247	386

Export sales were based on countries where the customers were located. Central and South America includes all countries south of the United States. Asia includes customers in Australia, China, India, Korea and New Zealand. Europe and other consists of Europe and Africa. The Middle East was primarily sales to Afghanistan and Iraq. Export sales from the Company's operations at December 31, were as follow (in thousands):

	2011	2010	2009
Central and South America	$ 3,852	$ 3,703	$ 4,056
Canada	1,759	1,959	1,236
Asia	1,570	1,746	2,904
Europe and other	473	736	731
Middle East	2,978	719	983
	$ 10,632	$ 8,863	$ 9,910

19. SUMMARIZED QUARTERLY UNAUDITED FINANCIAL DATA

	2011 Q1	Q2	Q3	Q4
Net Sales	$4,880,619	$3,848,508	$5,415,230	$6,078,012
Gross Profit	1,848,626	1,380,086	2,316,241	2,351,332
Operating Income (Loss)	454,452	(73,214)	826,730	921,191
Net Income (Loss)	$301,577	$(21,372)	$541,000	$699,469
Basic income per common share	$0.07	$0.00	$0.12	$0.15
Diluted income per common share	$0.06	$0.00	$0.11	$0.14

	2010 Q1	Q2	Q3	Q4
Net Sales	$4,899,840	$5,472,936	$5,833,904	$6,768,920
Gross Profit	1,911,511	2,343,781	2,565,869	3,273,775
Operating Income	505,758	907,048	1,157,869	1,846,183
Net Income	$333,743	$586,738	$782,295	$1,284,616

Basic income per common share	$0.07	$0.13	$0.17	$0.28
Diluted income per common share	$0.07	$0.12	$0.16	$0.26

	2009 Q1	Q2	Q3	Q4
Net Sales	$3,575,031	$4,786,898	$4,536,850	$7,952,365
Gross Profit	1,344,122	2,078,412	2,060,029	3,247,606
Operating Income (Loss)	(51,339)	696,862	739,242	1,947,952
Net Income	$68,154	$436,349	$521,014	$1,203,084
Basic income per common share	$0.01	$0.10	$0.11	$0.26
Diluted income per common share	$0.01	$0.09	$0.10	$0.24

The sum of the quarterly earnings per share amounts do not equal the amount reported for the full year since per share amounts are computed independently for each quarter and for the full year based on respective weighted-average shares outstanding and other dilutive potential shares.

20. LEGAL CONTINGENCIES

Various legal claims can arise from time to time in the normal course of business which, in the opinion of management, can have a material effect on our financial statements. We were named in a compensation claim under the Indian Anti-Trust Law that was filed in 2005 before The Monopolies and Restrictive Trade Practices Commission (the “Commission”) in New Delhi, India. The claim was dismissed by the Commission in March 2011.

Item 9 - Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A - Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report, we carried out an evaluation under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) of the Exchange Act). Disclosure controls and procedures are controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based upon this evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2011 because of the material weakness described below.

(b) Material Weakness in Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). Internal control over financial reporting is a process designed by, or under the supervision of, our principal executive officer and principal financial officer, and affected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement in the reporting company's annual or interim financial statements will not be prevented or detected on a timely basis.

Our management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2011 based upon criteria in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, management determined that our internal control over financial reporting was not effective as of December 31, 2011 because of the following material weakness in internal control over financial reporting:

- Procedures for the review of year end cutoff and accruals for revenue and expenses were not adequate to identify and correct errors in a timely manner.

As a result of these control weaknesses, management performed additional procedures at year end that were designed to ensure that the impact on the financial statements was minimized, and thus, management believes that the financial statements are accurate in all material respects.

(c) Changes in Internal Control Over Financial Reporting

We are committed to continuing to improve our internal control processes and will continue to review our financial reporting controls and procedures. As we continue to evaluate and work to improve our internal control over financial reporting, we will identify measures to address these material weaknesses. Our management, with the oversight of the audit committee of our board of directors, will continue to assess and take steps to enhance the overall design and capability of our control environment in the future.

(d) Attestation Report of the Independent Registered Public Accounting Firm

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Internal control over financial reporting was not subject to attestation by the Company's independent registered public accounting firm in accordance with recent amendments to Section 404 of the Sarbanes-Oxley Act of 2002 pursuant to Section 989G of the Dodd-Frank Wall Street Reform and Consumer Protection Act that permit the Company to provide only management's report in this Annual Report.

Item 9B – Other Information

None

PART III

Item 10 – Directors, Executive Officers and Corporate Governance

The Board has adopted a Code of Conduct and Ethics that applies to Sutron's principal executive officer, principal financial officer and all other employees of the Company. This Code of Conduct and Ethics is posted on the Company's website at http://www.sutron.com on the investors' page. Any amendments to the Code of Ethics and waivers of the Code of Ethics for our principal executive, accounting or financial officers will be published on our website.

The remainder of information required for this Item is incorporated by reference to the Proxy Statement to be filed in connection with our 2012 Annual Meeting of Shareholders.

Item 11 - Executive Compensation

The information required for this Item is incorporated by reference to the Proxy Statement to be filed in connection with our 2012 Annual Meeting of Shareholders.

Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required for this Item is incorporated by reference to the Proxy Statement to be filed in connection with our 2012 Annual Meeting of Shareholders.

Item 13 - Certain Relationships, Related Transactions and Directors Independence

The information required for this Item is incorporated by reference to the Proxy Statement to be filed in connection with our 2012 Annual Meeting of Shareholders.

Item 14 – Principal Accounting Fees and Services

The information required for this Item is incorporated by reference to the Proxy Statement to be filed in connection with our 2012 Annual Meeting of Shareholders.

PART IV

Item 15 – Exhibits, Financial Statements and Schedules

(a)(1 and 2) Financial Statements and Schedules

The financial statements listed in Item 8 in the Index to Consolidated Financial Statements on page 21 are filed as part of this report.

(b) Exhibits

3.2 Copy of Articles of Amendment to the Articles of Incorporation and Articles of Reduction of Stated Capital of the Company (incorporated by reference as filed with the Securities and Exchange Commission on September 16, 1983)
3.3 By-laws of the Company (incorporated by reference as filed with the Securities and Exchange Commission on September 16, 1983)
10.23 Form of Stock Option Plan*
10.24 Form of Stock Option Agreement*
10.25 Loan Modification Agreement dated September 16, 2011 between Sutron Corporation and Branch Banking and Trust Company of Virginia, a North Carolina Banking Corporation
23.1 Consent of Independent Registered Public Accounting Firm
31.1 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Chairman of the Board of Directors, President and Chief Executive Officer
31.2 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Chief Financial Officer and Treasurer
32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS XBRL Instance Document
101.SCH XBRL Taxonomy Extension Schema Document
101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF XBRL Taxonomy Extension Definition Linkbase Document
101.LAB XBRL Taxonomy Extension Label Linkbase Document
101.PRE XBRL Taxonomy Presentation Linkbase Document

* Indicates management contract or compensatory plan or arrangement

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Sutron Corporation
(Registrant)

/s/ Raul S. McQuivey Date: March 28, 2012
By: Raul S. McQuivey,
Chairman of the Board of Directors, President
and Chief Executive Officer

In accordance with the Securities Exchange Act, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Raul S. McQuivey Date: March 28, 2012
By: Raul S. McQuivey,
Chairman of the Board of Directors, President
and Chief Executive Officer

/s/ Daniel W. Farrell Date: March 28, 2012
By: Daniel W. Farrell,
Director and Senior Vice President

/s/ Andrew D. Lipman Date: March 28, 2012
By: Andrew D. Lipman, Director

/s/ Leland R. Phipps Date: March 28, 2012
By: Leland R. Phipps, Director

/s/ John F. DePodesta Date: March 28, 2012
By: John F. DePodesta, Director

/s/ Larry C. Linton Date: March 28, 2012
By: Larry C. Linton, Director

/s/ Ashish H. Raval Date: March 28, 2012
By: Ashish H. Raval, Director
and Senior Vice President

/s/ Sidney C. Hooper Date: March 28, 2012
By: Sidney C. Hooper, Chief Financial Officer
(Principal Financial and Accounting Officer)

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