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Deferred financing costs	(82)	(20)	(88)
Net cash provided by financing activities	94	15,377	483
Effect of exchange rate changes on cash	121	45	(19)
Net increase in cash and cash equivalents	1,307	16,996	102
Cash and cash equivalents at beginning of year	25,270	8,274	8,172
Cash and cash equivalents at end of period	$26,577	$25,270	$8,274
Supplemental cash flow disclosures			
Non-cash financing activities			
Issuance of 122,617 shares of common stock to acquire TAS Holdings Ltd.	$683	$-	$-

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

1. Business and basis of presentation

GSE Systems, Inc. ("GSE Systems", "GSE" or the "Company") provides training simulators and educational solutions to the energy, process, manufacturing and government sectors.

The Company's operations are subject to certain risks and uncertainties including, among others, rapid technological changes, success of the Company's product development, marketing and distribution strategies, the need to manage growth, the need to retain key personnel and protect intellectual property, and the availability of additional financing on terms acceptable to the Company.

At December 31, 2010, the Company had cash and cash equivalents of $26.6 million. Although the Company was in default on two of its financial covenants under its line of credit agreement, the Company has received a written waiver from its bank. At December 31, 2010, the Company had two separate revolving credit agreements for revolving lines of credit with BOA which were to expire on May 31, 2012. The credit facilities enabled the Company to borrow funds to support working capital needs and standby letters of credit. The first line of credit which was in the principal amount of up to $5.0 million. This line of credit was 90% guaranteed by the Export-Import Bank of the United States. The second line of credit was in the principal amount of up to $2.5 million. Both credit agreements contained financial covenants with respect to the Company's minimum tangible net worth, debt service coverage ratio, and funded debt to EBITDA ratio. The Company was in default on it's the funded debt to EBITDA ratio as of December 31, 2010. Due to the Company's financial covenant default, Bank of America ("BOA") has made the following amendments to the Company's revolving credit agreements effective March 14, 2011:

- A written waiver has been granted for the funded debt to EBITDA ratio default.
- The $5.0 million principal line of credit has been terminated.
- The financial covenants for the $2.5 million principal line of credit have been deleted.
- The Company is required to cash collateralize all outstanding standby letters of credit, which totals $3.4 million.
- All future letters of credit issued by BOA must be cash collateralized.
- Borrowings under the line of credit must be cash collateralized. Currently the Company has in place a $600,000 certificate of deposit as collateral for the line of credit.

Despite these changes to its lines of credit, the Company anticipates that its cash on hand and its normal operations will provide all of the funds necessary to fund its consolidated operations during the next twelve months. The Company believes that it will have sufficient liquidity and working capital without additional financing.

2. Summary of significant accounting policies

Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Accounting 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 revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates the estimates used, including but not limited to those related to revenue recognition, the allowance for doubtful accounts receivable, impairments of goodwill and other intangible assets, valuation of intangible assets acquired and contingent consideration issued in business acquisitions, and income taxes. Actual results could differ from these estimates.

Revenue recognition

The majority of the Company's revenue is derived through the sale of uniquely designed systems containing hardware, software and other materials under fixed-price contracts. In accordance with U.S. generally accepted accounting principles, the revenue under these fixed-price contracts is accounted for on the percentage-of-completion method. This methodology recognizes revenue and earnings as work progresses on the contract and is based on an estimate of the revenue and earnings earned to date, less amounts recognized in prior periods. The Company bases its estimate of the degree of completion of the contract by reviewing the relationship of costs incurred to date to the expected total costs that will be incurred on the project. Estimated contract earnings are reviewed and revised periodically as the work progresses, and the cumulative effect of any change in estimate is recognized in the period in which the change is identified. Estimated losses are charged against earnings in the period such losses are identified. The Company recognizes revenue arising from contract claims either as income or as an offset against a potential loss only when the amount of the claim can be estimated reliably and realization is probable and there is a legal basis of the claim.

As the Company recognizes revenue under the percentage-of-completion method, it provides an accrual for estimated future warranty costs based on historical and projected claims experience. The Company's long-term contracts generally provide for a one-year warranty on parts, labor and any bug fixes as it relates to software embedded in the systems.

The Company's system design contracts do not normally provide for "post customer support service" (PCS) in terms of software upgrades, software enhancements or telephone support. In order to obtain PCS, the customers must normally purchase a separate contract. Such PCS arrangements are generally for a one-year period renewable annually and include customer support, unspecified software upgrades, and maintenance releases. The Company recognizes revenue from these contracts ratably over the life of the agreements.

Revenue from the sale of software licenses which do not require significant modifications or customization for the Company's modeling tools are recognized when the license agreement is signed, the license fee is fixed and determinable, delivery has occurred, and collection is considered probable.

Revenue for contracts with multiple elements is recognized in accordance with ASC 605-25 Revenue Recognition-Multiple Element Arrangements.

Revenues from certain consulting or training contracts are recognized on a time-and-material basis. For time-and-material type contracts, revenue is recognized based on hours incurred at a contracted labor rate plus expenses.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments with maturities of three months or less at the date of purchase.

The Company had $17.0 million and $150,000 deposited in a money market account with BOA on December 31, 2010 and 2009, respectively. There were no other cash equivalents.

Contract receivables

Contract receivables include recoverable costs and accrued profit not billed which represents revenue recognized in excess of amounts billed. The liability “Billings in excess of revenue earned” represents billings in excess of revenue recognized.

Billed receivables are recorded at invoiced amounts. The allowance for doubtful accounts is based on historical trends of past due accounts, write-offs, and specific identification and review of past due accounts. The activity in the allowance for doubtful accounts is as follows:

(in thousands)	As of and for the Years ended December 31, 2010	2009	2008
Beginning balance	$ 1,746	$ 2	$ 2
Current year provision	294	1,744	-
Current year write-offs	-	-	-
Ending balance	$ 2,040	$ 1,746	$ 2

At a meeting of ESA’s three shareholders held at ESA on February 17, 2010, in response to ESA's deteriorating financial condition, the shareholders reached agreement to significantly reduce costs and begin to explore options up to and including the selling of ESA. Accordingly, the Company increased its allowance for doubtful accounts by $1.6 million for the outstanding trade receivable from ESA as of December 31, 2009.

Equipment and leasehold improvements, net

Equipment is recorded at cost and depreciated using the straight-line method with estimated useful lives ranging from three to ten years. Leasehold improvements are amortized over the life of the lease or the estimated useful life, whichever is shorter, using the straight-line method. Upon sale or retirement, the cost and related amortization are eliminated from the respective accounts and any resulting gain or loss is included in operations. Maintenance and repairs are charged to expense as incurred.

Software development costs

Certain computer software development costs are capitalized in the accompanying consolidated balance sheets in accordance with U.S. generally accepted accounting principles. Capitalization of computer software development costs begins upon the establishment of technological feasibility. Capitalization ceases and amortization of capitalized costs begins when the software product is commercially available for general release to customers. Amortization of capitalized computer software development costs is included in cost of revenue and is determined using the straight-line method over the remaining estimated economic life of the product, not to exceed three years.

Development expenditures

Development expenditures incurred to meet customer specifications under contracts are charged to contract costs. Company sponsored development expenditures are charged to operations as incurred and are included in selling, general and administrative expenses. The amounts incurred for Company sponsored development activities relating to the development of new products and services or the improvement of existing products and services, were approximately $1.6 million, $1.3 million, and $907,000, for the years ended December 31, 2010, 2009, and 2008, respectively. Certain of these expenditures were capitalized as software development costs. See Note 7, Software development costs.

Impairment of long-lived assets

Long-lived assets, such as property, plant, and equipment, capitalized computer software costs subject to amortization, and intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that 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 estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized at the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and would no longer be depreciated.

Goodwill and Intangible Assets

The Company's intangible assets include amounts recognized in connection with acquisitions, including customer relationships, contract backlog and software. Intangible assets are initially valued at fair market value using generally accepted valuation methods appropriate for the type of intangible asset. Amortization is recognized on a straight-line basis over the estimated useful life of the intangible assets, except for contract backlog which is recognized in proportion to the projected revenue streams of the related backlog. Intangible assets with definite lives are reviewed for impairment if indicators of impairment arise. Except for goodwill, the Company does not have any intangible assets with indefinite useful lives.

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company reviews its goodwill annually, on November 30, for impairment, or more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. For goodwill, the impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. No impairment losses were recognized in 2010, 2009 or 2008.

Foreign currency translation

Balance sheet accounts for foreign operations are translated at the exchange rate at the balance sheet date, and income statement accounts are translated at the average exchange rate for the period. The resulting translation adjustments are included in accumulated other comprehensive loss. Transaction gains and losses, resulting from changes in exchange rates, are recorded in operating income in the period in which they occur. For the years ended December 31, 2010, 2009, and 2008, foreign currency transaction gains/(losses) were approximately $(297,000), $130,000, and $41,000, respectively.

Warranty

As the Company recognizes revenue under the percentage-of-completion method, it provides an accrual for estimated future warranty costs based on historical experience and projected claims. The activity in the warranty accounts is as follows:

(in thousands)	As of and for the Years ended December 31,		
	2010	2009	2008
Beginning balance	$ 1,273	$ 1,066	$ 724
Current year provision	718	605	799
Current year claims	(330)	(407)	(448)
Currency adjustment	19	10	(9)
Ending balance	$ 1,680	$ 1,273	$ 1,066

Income taxes

Income taxes are provided under the asset and liability method. Under this method, deferred income taxes are determined based on the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized. Provision is made for the Company's current liability for federal, state and foreign income taxes and the change in the Company's deferred income tax assets and liabilities.

Stock-based compensation

Compensation expense related to share based awards is recognized on a pro rata straight-line basis based on the value of share awards that are scheduled to vest during the requisite service period. During the twelve months ended December 31, 2010, 2009 and 2008, the Company recognized $807,000, $906,000 and $650,000, respectively, of pre-tax stock-based compensation expense under the fair value method. As of December 31, 2010, the Company had $2.6 million of unrecognized compensation related to the unvested portion of outstanding stock option awards expected to be recognized through April 2016.

Loss per share

Basic loss per share is based on the weighted average number of outstanding common shares for the period. Diluted loss per share adjusts the weighted average shares outstanding for the potential dilution that could occur if stock options, warrants or convertible preferred stock were exercised or converted into common stock. The number of common shares and common share equivalents used in the determination of basic and diluted loss per share was as follows:

(in thousands, except for share and per share amounts)

	Years ended December 31,		
	2010	2009	2008
Numerator:			
Net loss attributed to common stockholders	$(2,249)	$(797)	$(690)
Denominator:			
Weighted-average shares outstanding for basic earnings per share	18,975,007	16,938,392	15,746,616
Effect of dilutive securities:			
Employee stock options, warrants and convertible preferred stock	-	-	-
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share	18,975,007	16,938,392	15,746,616
Shares related to dilutive securities excluded because inclusion would be anti-dilutive	1,679,907	1,791,757	1,196,746

Conversion of outstanding stock options and warrants was not assumed for the years ended December 31, 2010, 2009 and 2008 because the impact was anti-dilutive. Included in the shares related to dilutive securities excluded from the diluted earnings per share calculation for the years ended December 31, 2010, 2009 and 2008, respectively, were in the money options and warrants totaling 518,546 shares, 641,631 shares and 910,480 shares, respectively.

Concentration of credit risk

The Company is subject to concentration of credit risk with respect to contract receivables. Credit risk on contract receivables is mitigated by the nature of the Company's worldwide customer base and its credit policies. The Company's customers are not concentrated in any specific geographic region, but are concentrated in the energy industry. The following customers have provided more than 10% of the Company’s revenue for the indicated period:

	Years ended December 31,		
	2010	2009	2008
Slovenské elektrárne, a.s.	22.0%	13.5%	0.0%
Emerson Process Management	11.1%	12.1%	16.2%
Titan-2 Concern	5.0%	10.7%	0.0%
American Electric Power	0.9%	6.8%	10.5%

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Fair values of financial instruments

The carrying amounts of current assets and current liabilities reported in the Consolidated Balance Sheets approximate fair value due to their short term duration.

Deferred financing fees

The Company amortizes the cost incurred to obtain debt financing using the straight-line method over the term of the underlying obligations. The amortization of deferred financing costs is included in interest expense. Deferred financing costs are classified within other assets in the consolidated balance sheets.

Derivative instruments

The Company adopted ASC 815, Derivatives and Hedging, on January 1, 2009. ASC 815 enhances the disclosure requirements about an entity's derivative instruments and hedging activities.

The Company utilizes forward foreign currency exchange contracts to manage market risks associated with the fluctuations in foreign currency exchange rates. It is the Company's policy to use such derivative financial instruments to protect against market risk arising in the normal course of business in order to reduce the impact of these exposures. The Company minimizes credit exposure by limiting counterparties to nationally recognized financial institutions.

As of December 31, 2010, the Company had foreign exchange contracts outstanding of approximately 1.6 million Pounds Sterling, 10.6 million Euro, and 865.2 million Japanese Yen at fixed rates. At December 31, 2009, the Company had foreign exchange contracts outstanding of approximately 2 million Pounds Sterling, 3 million Euro, and 759 million Japanese Yen at fixed rates. The contracts expire on various dates through February 2014. The Company had not designated the foreign exchange contracts as hedges and had recorded the estimated fair value of the contracts in the consolidated balance sheet as follows:

	December 31,	
(in thousands)	2010	2009
Asset derivatives		
Prepaid expenses and other current assets	$ 208	$ 515
Other assets	117	396
	325	911
Liability derivatives		
Other current liabilities	(204)	(34)
Other liabilities	(40)	(65)
	(244)	(99)
Net fair value	$ 81	$ 812

The changes in the fair value of the foreign exchange contracts are included in gain (loss) on derivative instruments in the consolidated statement of operations.

The foreign currency denominated trade receivables, unbilled receivables, billings in excess of revenue earned and subcontractor accruals that are related to the outstanding foreign exchange contracts are remeasured at the end of each period into the functional currency using the current exchange rate at the end of the period. The gain or loss resulting from such remeasurement is also included in gain (loss) on derivative instruments in the consolidated statement of operations.

For the years ended December 31, 2010, 2009 and 2008, the Company recognized a net gain (loss) on its derivative instruments as outlined below:

	Year ended December 31,		
(in thousands)	2010	2009	2008
Foreign exchange contracts- change in fair value	$ (745)	$ 851	$ (174)
Remeasurement of related contract receivables and billings in excess of revenue earned	(168)	(88)	(279)
	$ (913)	$ 763	$ (453)

New accounting standards

In October 2009, the FASB issued Accounting Standards Update ("ASU") 2009-13, Revenue Recognition (Topic 605), Multiple-Deliverable Arrangements. ASU 2009-13 amends the guidance that in the absence of vendor-specific objective and third-party evidence for deliverables in multiple-deliverable arrangements, companies will be required to develop a best estimate of the selling price to separate deliverables and allocate arrangements consideration using the relative selling price method. ASU 2009-13 expands the disclosure requirements for multiple-deliverable revenue arrangements. The guidance will be effective for financial statements issued for fiscal years beginning after June 15, 2010. The Company does not anticipate the adoption of ASU 2009-13 to have a material impact on its financial statements.

In October 2009, the FASB issued ASU 2009-14, Software (Topic 985), Certain Revenue Arrangements that Include Software Elements. ASU 2009-14 amends the guidance to exclude for the scope of software revenue accounting requirements tangible products if the product contains both software and non-software components that function together to deliver a product's essential functionality and factors to consider in determining whether a product is within the scope of the guidance. The guidance will be effective for financial statements issued for fiscal years beginning after June 15, 2010. The Company does not anticipate the adoption of ASU 2009-14 to have a material impact on its financial statements.

3. Acquisition

Effective April 26, 2010, GSE Systems Inc., through its wholly owned subsidiary GSE Systems, Ltd. ("GSE UK"), completed the acquisition of TAS Holdings Ltd. ("TAS"), a provider of engineering consulting, specializing in electrical system design, instrumentation and controls engineering and automation engineering. GSE UK acquired 100% of the outstanding common stock of TAS. The purchase price for the common stock of TAS was equal to (i) the consolidated net asset value of TAS as of April 26, 2010, approximately $600,000, and (ii) four times the adjusted consolidated pre-tax income of TAS for the year ended September 30, 2009, approximately $1.7 million (the "Adjusted Profit Consideration"), for a total of approximately $2.3 million in cash, GSE Systems, Inc. common stock and contingent consideration.

Approximately $500,000 of the consolidated net asset value was paid on the closing date and the remaining $100,000 of the consolidated net asset value was paid during the third quarter 2010. On the closing date, the TAS Shareholders were entitled to receive approximately $683,000 (40% of the Adjusted Profit Consideration) payable in GSE common stock. Based upon the formula agreed to by the parties, the TAS Shareholders received 122,617 shares of GSE common stock.

On the first anniversary of the closing date, the TAS Shareholders are entitled to receive approximately $517,000 (30% of the Adjusted Profit Consideration) (the "First Payment"). At the option of GSE, the First Payment will be made either (i) 100% in cash or (b) 50% in cash and 50% in GSE Systems, Inc. common stock. The value of the GSE common stock will be based upon the weighted average of the closing prices of the common stock on the NYSE Amex stock exchange for the five-trading day period ending two trading days prior to the first anniversary of the closing date. If net profit before taxes of TAS for the nine month period ending December 31, 2010 is less than approximately $323,000, the First Payment will be reduced by an amount equal to four times the difference between (a) $323,000 and (b) the actual net profit before taxes of TAS for the nine-month period ending December 31, 2010.

On the second anniversary of the closing date, the TAS Shareholders are entitled to receive approximately $517,000 (30% of the Adjusted Profit Consideration) (the "Second Payment"). At the option of GSE, the Second Payment will be made either (i) 100% in cash or (ii) 50% in cash and 50% in GSE Systems, Inc. common stock. The value of the GSE common stock will be based upon the weighted average of the closing prices of the common stock on the NYSE Amex stock exchange for the five-trading day period ending two-trading days prior to the second anniversary of the closing date. If net profit before taxes of TAS for the twelve month period ending December 31, 2011 is less than approximately $431,000, the Second Payment will be reduced by an amount equal to four times the difference between (a) $431,000 and (b) the actual net profit before taxes of TAS for the twelve-month period ending December 31, 2011.

Of the $2.3 million gross purchase price, the Company accrued $740,000 of contingent consideration based on its estimate of the fair value of the potential contingent consideration payable to the TAS Shareholders on the first and second anniversaries of the closing date. The Company will estimate the fair value of the recorded amount of contingent consideration on a quarterly basis and any subsequent adjustments based on actual payments or revised estimates will be recognized in the selling, general, and administrative expenses of the consolidated statement of operations during the period of adjustment.

The estimated fair value of the purchase price recorded by the Company consisted of the following (in thousands):

Cash and stock purchase price	$	1,289
Estimated contingent consideration		740
Total estimated purchase price	$	2,029

The Company's purchase price allocation for the net assets acquired was as follows (in thousands):

	April 26, 2010 (unaudited)	
Cash	$	68
Contract receivables		594
Prepaid expenses and other current assets		17
Property, plant and equipment, net		496
Intangible assets		735
Goodwill		865
Total assets		2,775
Accounts payable, accrued expenses and other liabilities		703
Billings in excess of costs and estimated earnings on uncompleted contracts		43
Total liabilities assumed		746
Net assets acquired	$	2,029

The Company recorded intangible assets as a result of the acquisition, which included $686,000 relating to contractual and non-contractual customer relationships. Contractual customer relationships acquired totaled $208,000 and are being amortized over the remaining life of the contracts, 1-4 years. Non-contractual customer relationships acquired totaled $478,000 and are being amortized over an estimated useful life of 10 years. The Company acquired $35,000 of customer related intangible assets for contract backlog which are being amortized over 1 year subsequent to the acquisition, and $14,000 related to trademarks, domain names and other marketing related intangibles which are being amortized over an estimated useful life of 3 years. The intangible assets and accrued contingent consideration for TAS were recorded at estimated fair value.

TAS' results of operations are included in the consolidated financial statements for the period beginning April 26, 2010.

On the closing date, TAS entered into a sale and leaseback agreement with the TAS Shareholders. Under the terms of the agreement, the TAS Shareholders purchased the building occupied by TAS for approximately $377,000 in cash, which was paid on the closing date, and TAS entered into a five-year lease for approximately $31,000 per year, payable in equal monthly installments. TAS may terminate the lease after April 26, 2013 upon six months written notice.

Pro forma results. Our consolidated financial statements include the operating results of TAS from the date of acquisition. For the twelve months ended December 31, 2010 and 2009, the unaudited pro forma financial information below assumes that our material business acquisition of TAS occurred on January 1, 2009.

(in thousands)	Twelve Months Ended December 31, (unaudited)			
Pro forma financial information including the acquisition of TAS		2010		2009
Revenue	$	48,381	$	43,811
Operating income (loss)		(1,153)		400
Net loss		(2,185)		(63)
Loss per common share — basic	$	(0.12)	$	0.00
Loss per common share — diluted	$	(0.12)	$	0.00

4. Contract receivables

Contract receivables represent balances due from a broad base of both domestic and international customers. All contract receivables are considered to be collectible within twelve months. Recoverable costs and accrued profit not billed represent costs incurred and associated profit accrued on contracts that will become billable upon future milestones or completion of contracts. The components of contract receivables are as follows:

(in thousands)	December 31, 2010	2009
Billed receivables	$ 7,733	$ 8,183
Recoverable costs and accrued profit not billed	11,508	9,504
Allowance for doubtful accounts	(2,040)	(1,746)
Total contract receivables, net	$ 17,201	$ 15,941

5. Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following:

(in thousands)	December 31, 2010	December 31, 2009
Prepaid expenses	$ 416	$ 348
Employee advances	96	-
Deferred income taxes- current	35	-
Value added tax receivable	718	464
Other current assets	727	679
Total	$ 1,992	$ 1,491

6. Equipment and leasehold improvements

Equipment and leasehold improvements consist of the following:

(in thousands)	December 31, 2010	December 31, 2009
Computer equipment	$ 3,446	$ 2,954
Leasehold improvements	533	166
Furniture and fixtures	748	944
	4,727	4,064
Accumulated depreciation	(3,667)	(3,075)
Equipment and leasehold improvements, net	$ 1,060	$ 989

Depreciation expense was approximately $579,000, $504,000, and $446,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

7. Software development costs

Software development costs, net, consist of the following:

(in thousands)	December 31, 2010	December 31, 2009
Capitalized software development costs	$ 2,594	$ 2,318
Accumulated amortization	(804)	(453)
Software development costs, net	$ 1,790	$ 1,865

Software development costs capitalized were approximately $903,000 $861,000, and $591,000 for the years ended December 31, 2010, 2009, and 2008, respectively. Amortization of software development costs capitalized was approximately $978,000, $483,000, and $274,000, for the years ended December 31, 2010, 2009, and 2008, respectively, and was included in cost of revenue. In the fourth quarter of 2010, the Company wrote off the remaining capitalized value of four generic training simulators totaling $317,000.

8. Investment in Emirates Simulation Academy, LLC

On November 8, 2005, the Emirates Simulation Academy, LLC (“ESA”), headquartered in Abu Dhabi, United Arab Emirates, was formed to build and operate simulation training academies in the Arab Gulf Region. The members of the limited liability company include Al Qudra Holding PJSC of the United Arab Emirates (60% ownership), the Centre of Excellence for Applied Research and Training of the United Arab Emirates (30% ownership) and GSE (10% ownership). The Company accounted for its investment in ESA using the equity method. For the year ended December 31, 2009 and 2008, the Company recognized a $615,000 and $213,000 equity loss, respectively, on its investment in ESA. The equity loss was recorded in other income (expense), net.

In January 2006, GSE received a $15.1 million contract from ESA (the “ESA Contract”) to supply five simulators and an integrated training program. The Company received change orders totaling $1.8 million from ESA which increased the total order value to $16.9 million. For the year ended December 31, 2008, the Company recognized $1.2 million, of contract revenue on this project using the percentage-of-completion method, which accounted for 4.2% of the Company’s consolidated revenue. In accordance with the equity method of accounting, the Company eliminated 10% of the profit from the ESA Contract as the training simulators were assets that had been recorded on the books of ESA, and the Company was thus required to eliminate its proportionate share of the profit included in the asset value. The profit elimination totaled $28,000 for the year ended December 31, 2008, and was recorded as another liability on the balance sheet. ESA assigned a four year life to the simulators and began to amortize the training simulators on their books effective January 1, 2009. Accordingly, on January 1, 2009, GSE began to amortize the deferred profit to other income over a four year period, recognizing income of $181,000 in the year ended December 31, 2009.

The Company has provided a partial guarantee of 10% of ESA’s credit facility with Union National Bank (“UNB”); $1.2 million was deposited into a restricted interest-bearing account with UNB in 2006. The interest earned on the restricted cash is part of the pledged deposit.

At December 31, 2009, ESA had borrowed a total of AED 36.4 million ($9.9 million) from its credit facility with UNB, including accrued interest payable. ESA was delinquent in paying both principal and interest (a total of AED 5.3 million or $1.5 million) and in January 2010, UNB drew upon the guarantees of the three partners to pay off the delinquency, withdrawing $145,000 from GSE’s restricted cash account. In February 2010, GSE was notified that ESA had missed another loan payment and that 10% of the amount due ($24,000) would be withdrawn from the Company’s restricted cash account.

At a meeting of ESA’s three shareholders held at ESA on February 17, 2010, the shareholders reached agreement to significantly reduce costs and begin to explore options up to and including the selling of ESA.

Accordingly, based upon these events, the Company determined that its remaining investment in ESA at December 31, 2009 was impaired and established reserves for the $1.6 million trade receivable due from ESA at December 31, 2009 and for the cash that GSE has on deposit with UNB as a partial guarantee for ESA’s credit facility. Partially offsetting these charges was the reversal of the remaining deferred profit related to the Company’s sale of five simulators to ESA in prior years and the remaining agent fee that was due upon payment of the final outstanding receivable. The charges recorded and the presentation in the statement of operations for the year ended December 31, 2009 are as follows:

(in thousands)		Year ended December 31, 2009	
Trade receivable	$	1,604	
Accrued agent fee		(96	)
Operating expense		1,508	
Restricted cash- bank guarantee and accrued interest income		1,291	
Investment in ESA		117	
Deferred profit		(543	)
Other expense, net		865	
Total	$	2,373	

In 2010, Union National Bank withdrew a total of $294,000 from the cash GSE had on deposit with them as a partial guarantee against ESA's line of credit. Any interest income earned from this account in 2010 was not recorded in interest income but was credited to the reserve balance. At December 31, 2010 the Company had $1.0 million remaining in the UNB account which was fully reserved.

9. Fair Value of Financial Instruments

The Company adopted ASC 820, Fair Value Measurements and Disclosures for nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis in the first quarter of fiscal 2009, and such adoption did not have a material impact on the Company's financial statement disclosures.

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principle or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The levels of the fair value hierarchy established by ASC 820 are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

The Company considers the recorded value of certain of its financial assets and liabilities, which consist primarily of cash and cash equivalents, accounts receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at December 31, 2010 and December 31, 2009 based upon the short-term nature of the assets and liabilities.

The Company had $17.0 million and $150,000 deposited in a money market account with BOA on December 31, 2010 and 2009, respectively.

As of December 31, 2010, the Company was contingently liable for five standby letters of credit and three surety bonds totaling $4.7 million which represent performance bonds on eight contracts. The Company has deposited the full value of one standby letters of credit in certificates of deposit ($179,000) which have been restricted in that the Company does not have access to these funds until the related letters of credit have expired. The cash has been recorded on the Company's balance sheet at December 31, 2010 as restricted cash and long-term restricted cash depending on the expiration date of the certificate of deposit.

On May 5, 2009, one of the Company's two credit agreements with Bank of America was amended to include a $600,000 certificate of deposit issued by Bank of America in the borrowing base calculation to determine the maximum amount of available funds that the Company could borrow from the line. The cash deposited in this certificate of deposit has been recorded on the Company's balance sheet at December 31, 2010 and 2009 as restricted cash.

The following table presents assets and liabilities measured at fair value at December 31, 2010:

(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Money market fund	$ 17,017	$ -	$ -	17,017
Certificates of deposit	779	-	-	779
Foreign exchange contracts	-	325	-	325
Total assets	$ 17,796	$ 325	$ -	$ 18,121
Foreign exchange contracts	$ -	$ (244)	$ -	$ (244)
Total liabilities	$ -	$ (244)	$ -	$ (244)

10. Long-term debt

At December 31, 2010 and 2009, the Company had no long-term debt.

Line of Credit

At December 31, 2010, the Company had two separate revolving credit agreements for revolving lines of credit with BOA which were to expire on May 31, 2012. The Company and its subsidiary, GSE Power Systems, Inc., were jointly and severally liable as co-borrowers. The credit facilities enabled the Company to borrow funds to support working capital needs and standby letters of credit. The first line of credit which was in the principal amount of up to $3.5 million was amended on March 29, 2010 to increase the principal amount to $5.0 million. This revolving line of credit enabled the Company to borrow funds up to 90% of eligible foreign accounts receivable, plus 75% of eligible unbilled foreign receivables and 100% of cash collateral pledged to BOA on outstanding warranty standby letters of credit. This line of credit was 90% guaranteed by the Export-Import Bank of the United States. The interest rate on this line of credit is based on the daily LIBOR rate plus 150 basis points, with interest only payments due monthly. The second line of credit was in the principal amount of up to $2.5 million. This line of credit enabled the Company to borrow funds up to 80% of domestic accounts receivable, 30% of domestic unbilled receivables and 100% of the principal balance of a $600,000 certificate of deposit issued by BOA. The interest rate on this line of credit was based on the daily LIBOR rate plus 225 basis points, with interest only payments due monthly. The credit agreements contained certain restrictive covenants regarding future acquisitions, incurrence of debt and the payment of dividends. In addition, both credit agreements contained financial covenants with respect to the Company's minimum tangible net worth, debt service coverage ratio, and funded debt to EBITDA ratio. At December 31, 2010 and throughout all of 2010, the Company had not paid any interest or principal payments related to any borrowings for over one year. As such the debt service coverage ratio is not applicable at December 31, 2010. The financial covenant calculations at December 31, 2010 are shown below:

	Covenant	As of Dec. 31, 2010
Tangible net worth	Must Exceed $15.0 million	$31.8 million
Funded debt to EBITDA ratio	Not to Exceed 2.50 : 1.00	(30.90) : 1.00

For the funded debt to EBITDA ratio calculation, the amount of outstanding standby letters of credit and surety bonds that are not cash collateralized are included as funded debt. At December 31, 2010, the Company had outstanding standby letters of credit and surety bonds that were not cash collateralized of $4.4 million. Due to the Company's net loss of $2.2 million for the year ended December 31, 2010, the Company was in default on its funded debt to EBITDA ratio at December 31, 2010.

Due to the Company's financial covenant default, BOA has made the following amendments to the Company's revolving credit agreements effective March 14, 2011:

- A written waiver has been granted for the funded debt to EBITDA ratio default.
- The $5.0 million principal line of credit has been terminated.
- The financial covenants for the $2.5 million principal line of credit have been deleted.
- The Company is required to cash collateralize all outstanding standby letters of credit, which totals $3.4 million.
- All future letters of credit issued by BOA must be cash collateralized.
- Borrowings under the line of credit must be cash collateralized. Currently the Company has in place a $600,000 certificate of deposit as collateral for the line of credit.

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11. Income taxes

The consolidated income (loss) before income taxes, by domestic and foreign sources, is as follows:

(in thousands)	Years ended December 31,		
	2010	2009	2008
Domestic	$ (3,114)	$ (2,115)	$ (674)
Foreign	1,071	2,235	113
Total	$ (2,043)	$ 120	$ (561)

The provision for income taxes is as follows:

(in thousands)	Years ended December 31,		
	2010	2009	2008
Current:			
Federal	$ -	$ 29	$ -
State	9	80	10
Foreign	233	512	245
Subtotal	242	621	255
Deferred:			
Foreign	(36)	296	(126)
Subtotal	(36)	296	(126)
Total	$ 206	$ 917	$ 129

The Company is entitled to a deduction for federal and state tax purposes with respect to employees' stock option activity. The net reduction in taxes otherwise payable in excess of any amount credited to income tax benefit has been credited to additional paid-in capital. As of December 31, 2010, the Company had $5.6 million of unrecognized excess tax deductions related to compensation for stock option exercises which will be recognized when the net operating loss carryforwards are fully utilized and those excess tax benefits result in a reduction to income taxes payable.

The effective income tax rate differed from the statutory federal income tax rate due to the following:

	Effective Tax Rate Percentage (%) Years ended December 31,		
	2010	2009	2008
Statutory federal income tax rate	34.0 %	34.0 %	(34.0) %
State income taxes, net of federal tax benefit	(0.5)	44.1	1.2
Effect of foreign operations	(4.6)	(157.2)	0.2
Change in valuation allowance	(38.8)	669.6	39.6
Other, principally permanent differences	(0.2)	173.7	16.0
Effective tax rate	(10.1) %	764.2 %	23.0 %

Deferred income taxes arise from temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. A summary of the tax effect of the significant components of the deferred income tax assets (liabilities) is as follows:

(in thousands)	December 31,		
	2010	2009	2008
Deferred tax assets:			
Net operating loss carryforwards	$ 5,893	$ 5,650	$ 6,691
Capital loss carryforwards	2,472	2,443	1,675
Accruals and reserves	126	251	61
Expenses not currently deductible for tax purposes	1,358	1,153	412
Alternative minimum tax credit carryforwards	166	166	162
Other	1,163	660	654
Total deferred tax asset	11,178	10,323	9,655
Valuation allowance	(8,662)	(8,375)	(8,259)
Total deferred tax asset less valuation allowance	2,516	1,948	1,396
Deferred tax liabilities:			
Tax in excess of book depreciation	-	-	(8)
Undistributed earnings of foreign subsidiary	(1,790)	(1,313)	(683)
Software development costs	(677)	(724)	(579)
Other	(421)	(87)	-
Total deferred tax liability	(2,888)	(2,124)	(1,270)
Net deferred tax asset (liability)	$ (372)	$ (176)	$ 126

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities and projected future income in making this assessment.

Management believes that the Company will achieve profitable operations in future years that will enable the Company to recover the benefit of its deferred tax assets. However, other than for a portion of the deferred tax assets that are related to the Company's Swedish and English subsidiaries, the Company presently does not have sufficient objective evidence to substantiate the recovery of the deferred tax assets. Accordingly, the Company has established a full $8.7 million valuation allowance on its U.S. and Scottish deferred tax assets at December 31, 2010. The valuation allowance for deferred tax assets increased by $287,000 in 2010, increased by $116,000 in 2009 and decreased by $609,000 in 2008.

At December 31, 2010, the Company's largest deferred tax asset related to a U.S. net operating loss carryforward of $5.6 million which expires in various amounts between 2017 and 2030. The amount of U.S. loss carryforward which can be used by the Company each year is limited due to changes in the Company's ownership which occurred in 2003. Thus, a portion of the Company's loss carryforward may expire unutilized.

The Company is not aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits would significantly decrease or increase within the next twelve months.

The Company's policy for recording interest and penalties associated with uncertain tax positions is to record such items as a component of income tax expense. As of December 31, 2010, the Company has no accrued interest or penalties.

12. Capital stock

The Company's Board of Directors has authorized 32,000,000 total shares of capital stock, of which 30,000,000 are designated as common stock and 2,000,000 are designated as preferred stock. The Board of Directors has the authority to establish one or more classes of preferred stock and to determine, within any class of preferred stock, the preferences, rights and other terms of such class.

On September 4, 2009, the Company raised $15.0 million through the sale of 2.5 million shares of its common stock, $.01 par value per share. The shares were sold under a shelf registration statement which was declared effective by the Securities and Exchange Commission on August 21, 2009. On September 23, 2009, the Company raised an additional $2,250,000 when the Company's underwriter, exercised an over-allotment option in full to purchase an additional 375,000 shares of the Company's common stock at the public offering price of $6.00 per share. The aggregate net proceeds received by the Company from the two transactions was approximately $15.9 million. The Company paid the underwriter a fee in the amount of 6% of the gross proceeds received by the Company from the offering ($1,035,000) and paid 339,000 in other transaction fees.

As of December 31, 2010, the Company has reserved 2,589,683 shares of common stock for issuance: 2,016,617 shares upon exercise of outstanding stock options; 257,511 shares upon exercise of outstanding warrants; 148,888 shares for future grants under the Company's 1995 Long-Term Incentive Plan; and 166,667 shares upon exercise of warrants that the Company is obligated to issue in the event of a default under its June 2007 common stock sale.

13. Stock-based compensation

Long-term incentive plan

During 1995, the Company established the 1995 Long-Term Incentive Stock Option Plan (the "Plan"), which permits the granting of stock options (including incentive stock options and nonqualified stock options) stock appreciation rights, restricted or unrestricted stock awards, phantom stock, performance awards or any combination of these to employees, directors or consultants. Options to purchase shares of the Company's common stock under the Plan expire in either seven or ten years from the date of grant and generally become exercisable in three installments with 40% vesting on the first anniversary of the grant date and 30% vesting on each of the second and third anniversaries of the grant date, subject to acceleration under certain circumstances. The Plan expires on June 30, 2018; the total number of shares that could be issued under the Plan is 3,500,000. As of December 31, 2010, the Company had 148,888 shares of common stock reserved for future grants under the Plan.

The Company recognizes compensation expense on a pro rata straight-line basis over the requisite service period for stock-based compensation awards with both graded and cliff vesting terms. The Company recognizes the cumulative effect of a change in the number of awards expected to vest in compensation expense in the period of change. The Company has not capitalized any portion of its stock-based compensation.

During the years ended December 31, 2010, 2009, and 2008, the Company recognized $807,000, $906,000 and $650,000, respectively of pre-tax stock-based compensation expense under the fair value method.

Stock option and warrant activity

During the year ended December 31, 2010, the Company granted stock options to purchase 422,143 shares of common stock to GSE directors, officers, and employees. No warrants to purchase shares of common stock were issued in 2010.

Information with respect to stock option and warrant activity as of and for the year ended December 31, 2010 is as follows:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted Average Remaining Contractual Life (Years)
Shares under option and warrant, December 31, 2009	2,061,611	$ 4.33		
Options granted	422,143	4.22		
Options exercised	(57,000)	1.67		
Warrants exercised	(45,198)	1.77		
Options expired	(285)	5.95		
Options forfeited	(107,143)	5.95		
Shares under option and warrant, December 31, 2010	2,274,128	4.35	$ 1,538	4.46
Options expected to vest	902,294	5.35	$ 45	6.65

A summary of the status of the Company's nonvested options as of and for the year ended December 31, 2010 is presented below. All outstanding warrants were vested prior to 2010.

	Number of Shares	Weighted Average Fair Value
Nonvested options at December 31, 2009	827,723	$ 4.35
Options granted	422,143	1.52
Options vested during the period	(240,144)	3.74
Options forfeited	(107,143)	4.34
Nonvested options at December 31, 2010	902,579	$ 3.19

The fair value of the options granted in 2010, 2009 and 2008 were estimated on the date of grant using a Black-Scholes option-pricing model with the following assumptions:

	Years ended December 31,		
	2010	2009	2008
Risk-free interest rates	.57% - 2.93%	1.71% - 3.04%	2.75% - 3.05%
Dividend yield	0%	0%	0%
Expected life	2.5 - 6.5 years	5.5 - 7.0 years	4.9 - 8.5 years
Volatility	37.2 - 63.8%	65.9% - 78.22%	68.8% - 78.22%
Weighted average volatility	55.38%	67.85%	77.40%

As of December 31, 2010, the Company had $2.6 million of unrecognized compensation expense related to the unvested portion of outstanding stock options expected to be recognized on a pro-rata straight line basis over a weighted average remaining service period of approximately 4.9 years.

The Company received cash for the exercise price associated with stock options exercised of $95,000, $103,000, and $282,000 during the years ended December 31, 2010, 2009, and 2008, respectively. The total intrinsic value realized by participants on stock options exercised was $159,000, $213,000 and $1.4 million during the years ended December 31, 2010, 2009, and 2008, respectively.

Common stock issued for services provided

In April 2006, the Company entered into a consulting agreement with an investor relations firm. After the initial term, the consulting agreement was extended for an additional eighteen months from November 2007 through April 2009 and an additional 25,000 shares of common stock was issued as partial compensation for services rendered, with the shares vesting in monthly increments of 1,388 shares. The Company delivered the 25,000 common shares to the investor relations firm in April 2009.

The consulting agreement was extended again for an additional eighteen months from May 2009 through October 2010 and an additional 30,000 shares of common stock was issued as partial compensation for services rendered, with the shares vesting in monthly increments of 1,666. The Company delivered the 30,000 shares of common stock to the investor relations firm in October 2010.

Compensation expense is determined based on the price per share on the last day of each month. In October 2010, the consulting agreement expired. For the ten months ended October 31, 2010, the average price per share was $4.55 and the total compensation expense recognized by the Company was $76,000. For the year ended December 31, 2009, the average price per share was $5.96 and the total compensation expense recognized by the Company was $113,000. For the year ended December 31, 2008, the average price per share was $7.87 and the total compensation expense recognized by the Company was $131,000.

14. Commitments and contingencies

Leases

The Company is obligated under certain noncancelable operating leases for office facilities and equipment. Future minimum lease payments under noncancelable operating leases as of December 31, 2010 are as follows:

(in thousands)	Gross Future Minimum Lease Payments	
2011	$	715
2012		604
2013		525
2014		430
2015		443
Thereafter		1,204
Total	$	3,921

Total rent expense under operating leases for the years ended December 31, 2010, 2009, and 2008 was approximately $942,000, $867,000, and $921,000, respectively.

Standby Letters of credit, bank guarantees, surety bonds and performance bonds

As of December 31, 2010, the Company was contingently liable for five standby letters of credit and three surety bonds totaling $4.7 million which represent performance bonds on eight contracts. The Company has deposited the full value of one standby letter of credit, $179,000, in a certificate of deposit, which has been restricted in that the Company does not have access to these funds until the related letter of credit has expired. The cash has been recorded on the Company's balance sheet at December 31, 2010 as restricted cash.

The Company has provided a partial guarantee of 10% of ESA's credit facility with Union National Bank; $1.2 million was deposited into a restricted interest-bearing account with UNB in 2006. The interest earned on the restricted cash is part of the pledged deposit. In January 2010, the Company was notified by UNB that ESA was delinquent in making principal and interest payments on the outstanding borrowings from their credit facility and that UNB had drawn upon the guarantees of the three partners to pay off the delinquency. The Company established a full reserve against the $1.3 million restricted cash account as of December 31, 2009. In 2010, Union National Bank withdrew a total of $294,000 from the cash GSE had on deposit with them as a partial guarantee against ESA's line of credit. Any interest income earned from this account in 2010 was not recorded in interest income but was credited to the reserve balance. At December 31, 2010 the Company had $1.0 million remaining in the UNB account which was fully reserved.

Contingencies

Various actions and proceedings are presently pending to which the Company is a party. In the opinion of management, the aggregate liabilities, if any, arising from such actions are not expected to have a material adverse effect on the financial position, results of operations or cash flows of the Company.

15. Employee benefits

The Company has a qualified defined contribution plan that covers substantially all U.S. employees under Section 401(k) of the Internal Revenue Code. Under this plan, the Company's stipulated basic contribution matches a portion of the participants' contributions based upon a defined schedule. The Company's contributions to the plan were approximately $245,000, $197,000, and $171,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

16. Segment information

The Company has one reportable business segment that provides simulation solutions and services to the nuclear and fossil fuel power industry, and to the chemical and petrochemical industries. Contracts typically range from 10 months to three years.

For the years ended December 31, 2010, 2009, and 2008, 72%, 73%, and 54% of the Company’s consolidated revenue was from customers in the nuclear power industry, respectively. The Company designs, develops and delivers business and technology solutions to the energy industry worldwide. Revenue, operating income (loss) and total assets for the Company’s United States, European, and Asian subsidiaries as of and for the years ended December 31, 2010, 2009, and 2008 are as follows:

(in thousands)	Year ended December 31, 2010				
	United States	Europe	Asia	Eliminations	Consolidated
Contract revenue	$37,197	$9,699	$317	$ -	$ 47,213
Transfers between geographic locations	(674)	121	553	-	-
Total contract revenue	$36,523	$9,820	$870	$ -	$ 47,213
Operating income (loss)	$(2,397)	$1,157	$8	$ -	$ (1,232)
Total assets, at December 31	$70,783	$12,689	$353	$ (30,211)	$ 53,614

(in thousands)	Year ended December 31, 2009				
	United States	Europe	Asia	Eliminations	Consolidated
Contract revenue	$34,056	$6,004	$-	$ -	$ 40,060
Transfers between geographic locations	323	30	604	(957)	-
Total contract revenue	$34,379	$6,034	$604	$ (957)	$ 40,060
Operating income (loss)	$(536)	$1,018	$81	$ -	$ 563
Total assets, at December 31	$71,216	$5,710	$231	$ (27,637)	$ 49,520

(in thousands)	Year ended December 31, 2008				
	United States	Europe	Asia	Eliminations	Consolidated
Contract revenue	$24,483	$4,521	$-	$ -	$ 29,004
Transfers between geographic locations	177	23	407	(607)	-
Total contract revenue	$24,660	$4,544	$407	$ (607)	$ 29,004
Operating income (loss)	$(682)	$641	$29	$ -	$ (12)
Total assets, at December 31	$55,460	$3,110	$82	$ (27,637)	$ 31,015

Approximately 71%, 65%, and 63% of the Company's 2010, 2009, and 2008 revenue, respectively, was derived from international sales of its products and services from all of its subsidiaries.

17. Supplemental disclosure of cash flow information

(in thousands)	Year ended December 31,		
	2010	2009	2008
Cash paid:			
Interest	$ -	$ 1	$ 2
Income taxes	$ 545	$ 206	$ 68

18. Quarterly financial data (unaudited)

The Company’s quarterly financial information has not been audited but, in management’s opinion, includes all adjustments necessary for a fair presentation.

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(in thousands, except per share data)

	Year ended December 31, 2010 Quarterly Data			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Contract revenue	$11,208	$11,773	$11,904	$12,328
Operating income (loss)	453	751	(328)	(2,108)
Net income (loss)	449	370	(548)	(2,520)
Basic income (loss) per common share	$0.02	$0.02	$(0.03)	$(0.13)
Diluted income (loss) per common share	$0.02	$0.02	$(0.03)	$(0.13)

(in thousands, except per share data)

	Year ended December 31, 2009 Quarterly Data			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Contract revenue	$8,128	$10,650	$10,217	$11,065
Operating income (loss)	531	658	428	(1,054)
Net income (loss)	333	571	458	(2,159)
Basic income (loss) per common share	$0.02	$0.04	$0.03	$(0.11)
Diluted income (loss) per common share	$0.02	$0.03	$0.03	$(0.11)

19. Subsequent Events

On January 4, 2011, GSE Systems, Inc. (“GSE”) completed the acquisition of EnVision Systems, Inc. (“EnVision”). EnVision is headquartered in Madison, NJ and has an office in Chennai, India. EnVision’s tutorials and simulation models serve the rapidly growing entry-level training market for the oil & gas, refining, and specialty chemicals industries. EnVision’s products provide a foundation in process fundamentals, and plant operations and interaction. With this knowledge base, users may then graduate to the full-scope, high-fidelity, real-time simulations provided by GSE. EnVision has an installed base of more than 750 systems in over 28 countries, and its approximately 130 clients include Shell Oil Company, BP, Total and Chevron. EnVision will operate as a wholly-owned subsidiary of GSE, and has been re-named GSE Envision, Inc.

On the Closing Date, GSE paid $1.2 million in cash to the shareholders of EnVision. In addition, if EnVision attains certain revenue targets for the four-year period ending December 31, 2014, the shareholders of EnVision could receive up to an additional $3.05 million.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by it in its reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that information required to be disclosed by the Company in its Exchange Act reports is accumulated and communicated to management, including the Company's Chief Executive Officer ("CEO"), who is its principal executive officer, and Chief Financial Officer ("CFO"), who is its principal financial officer, to allow timely decisions regarding required disclosure. At the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of our management including our CEO and our CFO, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13-15(e) of the Exchange Act. Based on the evaluation of our disclosure controls and procedures as of December 31, 2010, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act rule 13a-15(f). Our internal control processes and procedures are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements in accordance with United States generally accepted accounting principles.

Under the supervision and with the participation of management, including our CEO and CFO, we conducted an evaluation of internal control over financial reporting as of December 31, 2010 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework. Based upon our evaluation, we concluded that our internal control over financial reporting was effective as of December 31, 2010.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2010 has been audited by KPMG LLP, an independent registered public accounting firm, whose report appears in Item 8 of this Annual Report on Form 10-K.

(c) Changes in Internal Control over Financial Reporting

The Company has made no changes in its internal controls over financial reporting during the quarter ended December 31, 2010 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

(d) Limitation of Effectiveness of Controls

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate this risk.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information required by this item, including items 401, 405 406 and 407 of Regulation S-K, is incorporated by reference to the section captioned “Directors and Executive Officers” in the definitive Proxy Statement for the Company’s 2011 Annual Meeting of Shareholders and incorporated herein by reference or will be provided in an amendment to this Annual Report on Form 10-K.

The Company has adopted a Conduct of Business Policy that applies to its directors, officers and employees, including its principal executive officer, and principal financial officer. The Conduct of Business Policy is available on the Company’s website at www.gses.com. In addition, the Company has adopted a Code of Ethics for its principal executive officer and senior financial officers which is also available on the Company’s website. The Company will post on its website information about any amendment to, or waiver from, any provision of the Code of Ethics that applies to its principal executive officer, principal financial officer, or principal accounting officer.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this item will either be set forth under the “Executive Compensation” section in the definitive Proxy Statement for the 2011 Annual Meeting of Shareholders and incorporated herein by reference or will be provided in an amendment to this Annual Report on Form 10-K.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by this item will be either set forth under the sections captioned “Voting Securities and Principal Holders Thereof,” and “Executive Compensation” in the definitive Proxy Statement for the 2011 Annual Meeting of Shareholders and incorporated herein by reference or will be provided in an amendment to this Annual Report on Form 10-K.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

The information required by this item will be either set forth under the “Directors and Executive Officers” section in the definitive Proxy Statement for the 2011 Annual Meeting of Shareholders and incorporated herein by reference or will be provided in an amendment to this Annual Report on Form 10-K.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information required by this item will be either set forth under the “Directors and Executive Officers” section in the definitive Proxy Statement for the 2011 Annual Meeting of Shareholders and incorporated herein by reference or will be provided in an amendment to this Annual Report on Form 10-K.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) List of Financial Statements

The following financial statements are included in Item 8:

GSE Systems, Inc. and Subsidiaries

Report of Independent Registered Public Accounting Firm – Internal Control over Financial Reporting
Report of Independent Registered Public Accounting Firm – Consolidated Financial Statements
Consolidated Balance Sheets as of December 31, 2010 and 2009

Consolidated Statements of Operations for the years ended December 31, 2010, 2009, and 2008
Consolidated Statements of Comprehensive Loss for the years ended December 31, 2010,
2009, and 2008
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31,
2010,
2009, and 2008
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009, and 2008
Notes to Consolidated Financial Statements

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(a) (2) List of Schedules

All other schedules to the consolidated financial statements are omitted as the required information is either inapplicable or presented in the consolidated financial statements or related notes.

(a) (3) List of Exhibits

The Exhibits which are filed with this report or which are incorporated by reference are set forth in the Exhibit Index hereto.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GSE Systems, Inc.

By: / s / JAMES A. EBERLE
James A. Eberle
Chief Executive Officer

Pursuant to the requirements of the Securities Act, this report has been signed by the following persons in the capacities and on the dates indicated.

Date: March 14, 2011	/s / JAMES A. EBERLE James A. Eberle, Chief Executive Officer (Principal Executive Officer)
Date: March 14, 2011	/ s / JEFFERY G. HOUGH Jeffery G. Hough, Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

Date: March 8, 2011	(Jerome I. Feldman, Chairman of the Board	)	By: / s / JEFFERY G. HOUGH
	(Michael D. Feldman, Director	)	Jeffery G. Hough
	(Dr. Sheldon L. Glashow, Director	)	Attorney-in-Fact
	(Jane Bryant Quinn, Director	)	
	(Dr. Roger Hagengruber, Director	)	
	(Joseph W. Lewis, Director	)	
	(George J. Pedersen, Director	)	
	(Orrie Lee Tawes III, Director	)	

A Power of Attorney, dated March 8, 2011 authorizing Jeffery G. Hough to sign this Annual Report on Form 10-K for the fiscal year ended December 31, 2010 on behalf of certain of the directors of the Registrant is filed as Exhibit 24.1 to this Annual Report.

Exhibit	Description of Exhibit
1	Underwriting Agreement
1.1	Underwriting Agreement, dated August 31, 2009 between the Company and Roth Capital Partners, LLC. Previously filed in connection with Form 8-K as filed with the Securities and Exchange Commission on September 1, 2009 and incorporated herein by reference.
2	Plan of acquisition, reorganization, arrangement, liquidation, or succession
2.1	Share Purchase Agreement relating to TAS Holdings, Ltd. dated April 26, 2010, by and between John Maplesden, Anthony Maplesden, and John Easton and GSE Systems, Ltd and GSE Systems, Inc. previously filed with Form 8-K as filed with the Securities and Exchange Commission on April 30, 2010.
2.2	Contract for the Sale and Leaseback of Land and Buildings at 37-39 Norton Road, Stockton-on-Tees TS18 2BU between TAS Holdings Ltd. and John Maplesden, Anthony Maplesden and John Easton, dated April 26, 2010, previously filed with Form 8-K as filed with the Securities and Exchange Commission on April 30, 2010.
2.3	Stock Purchase Agreement, dated as of January 1, 2011 among GSE Systems, Inc., Toshi Shinohara, Santosh Joshi, Hideo Shinohara, and EnVision Systems, Inc. Previously filed with Form 8-K as filed with the Securities and Exchange Commission on January 10, 2011.
2.4	Employment Agreement, dated as of January 1, 2011 between Santosh Joshi and EnVision Systems, Inc. Previously filed with Form 8-K as filed with the Securities and Exchange Commission on January 10, 2011.
3	Articles of Incorporation and Bylaws
3(i)	Fourth Amended and Restated Certificate of Incorporation of the Company. Previously filed in connection with the GSE Systems, Inc. Form DEF 14A as filed with the Securities and Exchange Commission on November 20, 2007 and incorporated herein by reference.

3(ii) Amended and Restated Bylaws of the Company. Previously filed in connection with Form DEF 4A as filed with the Securities and Exchange Commission on November 20, 2007 and incorporated herein by reference.

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4. Instruments Defining Rights of Security Holders, including Indenture.

4.1 Specimen Common Stock Certificate of the Company. Previously filed in connection with Amendment No. 3 to the GSE Systems, Inc. Form S-1 Registration Statement as filed with the Securities and Exchange Commission on July 24, 1995 and incorporated herein by reference.

4.2 Form of Warrant to Purchase 166,667 shares of Common Stock of GSE Systems, Inc. dated as of June 15, 2007. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on June 18, 2007 and incorporated herein by reference.

4.3 Securities Purchase Agreement, dated as of June 15, 2007 by and between GSE Systems, Inc. and each of the Investors to sell a total of 1,666,667 shares of GSE Common Stock. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on June 18, 2007 and incorporated herein by reference.

4.4 Registration Rights Agreement, dated as of June 15, 2007 by and between GSE Systems, Inc. and each of the Investors. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on June 18, 2007 and incorporated herein by reference.

4. 5 Consent and Waiver, dated as of June 15, 2007, among GSE Systems, Inc., GSE Power Systems, Inc. and Laurus Master Fund Ltd. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on June 18, 2007 and incorporated herein by reference.

10. Material Contracts

10.1 Agreement among ManTech International Corporation, National Patent Development Corporation, GPS Technologies, Inc., General Physics Corporation, Vattenfall Engineering AB and GSE Systems, Inc. (dated as of April 13, 1994). Previously filed in connection with the GSE Systems, Inc. Form S-1 Registration Statement as filed with the Securities and Exchange Commission on April 24, 1995 and incorporated herein by reference.

10.2GSE Systems, Inc. 1995 Long-Term Incentive Plan, amended as of September 25, 2007. Previously filed in connection with the GSE Systems, Inc. Form DEF 14A as filed with the Securities and Exchange Commission on November 20, 2007 and incorporated herein by reference. *

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10.3 Form of Option Agreement Under the GSE Systems, Inc. 1995 Long-Term Incentive Plan. Previously filed in connection with the GSE Systems, Inc. Form 10-K as filed with the Securities and Exchange Commission on March 22, 1996 and incorporated herein by reference. *

10.4 Memorandum of Association of Limited Liability Company dated November 8, 2005 by and between Al Qudra Holding PJSC, Centre of Excellence for Applied Research and Training, and GSE Systems, Inc. Previously filed in connection with the GSE Systems, Inc. Form 10-Q/A filed with the Securities and Exchange Commission on October 4, 2006 and incorporated herein by reference.

10.5 Supply Agreement Contract by and between Emirates Simulation Academy, LLC and GSE Power Systems, Inc. dated January 3, 2006. Previously filed in connection with the GSE Systems, Inc. Form 10-Q/A filed with the Securities and Exchange Commission on October 4, 2006 and incorporated herein by reference.

10.6 License and Technology Transfer Agreement by and Between GSE Power Systems, Inc. and Emirates Simulation Academy, LLC dated January 3, 2006. Previously filed in connection with the GSE Systems, Inc. Form 10-Q/A filed with the Securities and Exchange Commission on October 4, 2006 and incorporated herein by reference.

10.7 Office Lease Agreement between 1332 Londontown, LLC and GSE Systems, Inc. (dated as of February 27, 2008). Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on March 11, 2008 and incorporated herein by reference.

10.8 $3,500,000 Ex-Im Bank-Guaranteed Transaction Specific Revolving Line of Credit, dated as of March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.9 Security Agreement by and among GSE Systems, Inc., GSE Power Systems, Inc and Bank of America, N.A. dated March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.10 Borrower Agreement by and among GSE Systems, Inc., GSE Power Systems, Inc. and Bank of America, N.A. dated March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.11 $1,500,000 Domestic Revolving Line of Credit dated as of March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.12 Security Agreement by and among GSE Systems, Inc., GSE Power Systems, Inc. and Bank of America, N.A. dated as of March 28, 2008 (Domestic Revolving Line of Credit). Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.13 Continuing and Unconditional Guaranty by GSE Process Solutions, Inc. and Bank of America, N.A. dated as of March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.14 Continuing and Unconditional Guaranty by MSHI, Inc. and Bank of America, N.A. dated as of March 28, 2008. Previously filed in connection with the GSE Systems,
10.15 Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

Pledge Agreement by and among the Company, MSHI, Inc., GSE Power Systems, Inc., GSE Process Solutions, Inc. and Bank of America, N.A. dated as of March 28, 2008. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 3, 2008 and incorporated herein by reference.

10.16 First Amendment to $1,500,000 Domestic Revolving Line of Credit, dated May 5, 2009. Previously filed in connection with the GSE Systems, Inc. Form 10-Q as filed with the Securities and Exchange Commission on May 11, 2009 and incorporated herein by reference.

10.17 First Amendment to Security Agreement by and among GSE Systems, Inc., GSE Power Systems, Inc. and Bank of America N.A (Domestic Revolving Line of Credit), dated as of May 5, 2009. Previously filed in connection with the GSE Systems, Inc. Form 10-Q as filed with the Securities and Exchange

Commission on May 11, 2009 and incorporated herein by reference.

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10.18 Ratification of Guarantee by GSE Process Solutions, Inc. and MSHI, Inc. (Ex-Im Bank-Guaranteed Transaction Specific Revolving Line of Credit), dated May 5, 2009. Previously
10.19 filed in connection with the GSE Systems, Inc. Form 10-Q as filed with the Securities and Exchange Commission on May 11, 2009 and incorporated herein by reference.
10.20
Second Amendment to Loan Agreement (Ex-Im Bank-Guaranteed Transaction Specific Revolving Line of
10.21 Credit) dated March 29, 2010. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 2, 2010 and
10.22 incorporated herein by reference.

Second Amendment to Loan Agreement (Domestic Revolving
10.23 Line of Credit) dated March 29, 2010. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 2, 2010 and incorporated herein by reference.

Ratification of Guaranty (Ex-Im Bank-Guaranteed Transaction Specific Revolving Line of Credit) dated March 29, 2010. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 2, 2010 and incorporated herein by reference.

Ratification of Guaranty (Domestic Revolving Line of Credit) dated March 29, 2010. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 2, 2010 and incorporated herein by reference.

Consulting Agreement, dated as of April 30, 2010 between John V. Moran and GSE Systems, Inc. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on April 30, 2010 and incorporated herein by reference.

10.24 Employment Agreement dated as of November 1, 2010 between GSE Systems, Inc. and James Eberle. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed
10.25 with the Securities and Exchange Commission on November 1, 2010 and incorporated herein by reference.*

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10.27	Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Chin-our Jerry Jen. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on February 2, 2011 and incorporated herein by reference.
	Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Jeffery G. Hough. Previously filed in connection with the GSE Systems, Inc. Form 8-K as filed with the Securities and Exchange Commission on February 2, 2011 and incorporated herein by reference.
	Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Michael D. Feldman, filed herewith.

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10.28 Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Gill Grady. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on February 2, 2011 and incorporated herein by reference.*

10.29 Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Lawrence Gordon, filed herewith.

10.30 Third Amendment to Loan Agreement (Ex-Im Bank-Guaranteed Transaction Specific Revolving Line of Credit) dated March 14, 2011. Filed herewith.

10.31 Third Amendment to Loan Agreement (Domestic Revolving Line of Credit) dated March 14, 2011. Filed herewith.

10.32 Ratification of Guaranty (Domestic Revolving Line of Credit) dated March 14, 2011. Filed herewith.

10.33 Employment Agreement dated as of January 1, 2011 between GSE Systems, Inc. and Jerome I. Feldman. Previously filed in connection with the GSE Systems, Inc. Form 8-K filed with the Securities and Exchange Commission on February 2, 2011 and incorporated herein by reference.

14. Code of Ethics

14.1 Code of Ethics for the Principal Executive Officer and Senior Financial Officers. Previously filed in connection with the GSE Systems, Inc. Form 10-K filed with the Securities and Exchange Commission on March 31, 2006 and incorporated herein by reference.

21. Subsidiaries.

21.1 List of Subsidiaries of Registrant at December 31, 2010, filed herewith.

23. Consents of Experts and Counsel

23.1. Consent of KPMG LLP, filed herewith.

24. Power of Attorney

24.1 Power of Attorney for Directors’ and Officers’ Signatures on SEC Form 10-K, filed herewith.

31. Certifications

31.1 Certification of Chief Executive Officer of the Company pursuant to Securities and Exchange Act Rule 13d-14(a)/15(d-14(a), as adopted pursuant to Section 302 and 404 of the Sarbanes-Oxley Act of 2002, filed herewith.

31.2 Certification of Chief Financial Officer of the Company pursuant to Securities and Exchange Act Rule 13d-14(a)/15(d-14(a), as adopted pursuant to Section 302 and 404 of the Sarbanes-Oxley Act of 2002, filed herewith.

32. Section 1350 Certifications

32.1 Certification of Chief Executive Officer and Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, file herewith.

* Management contracts or compensatory plans required to be filed as exhibits pursuant to Item 14 (c) of this report.