

TREASURER'S REPORT TO EXECUTIVE COMMITTEE HISTORY OF SCIENCE SOCIETY

5 October 2010

1. Introduction

After the preceding year, and thanks in part to the careful budgeting that took place then, the fiscal management of the Society during fiscal year 2010 was relatively straightforward and without drama.

The payment from the University of Chicago Press remains the Society's most important source of income, followed by the draw on the general endowment. We have had some donations to various funds and continue to encourage donations to the general fund rather than to the endowment. These would have the immediate benefit of more unrestricted funds to cover continuing operating expenses, but the amounts donated are still quite small relative to the two main sources of income and relative to expenses.

2. Endowment and Draw Calculations

The long-term financial well-being of the Society is tied to the well-being of the endowment, which necessarily exposes the Society to the risks inherent in the financial markets, as the last few years have so forcefully reminded us. Donations to the general endowment have not increased since the completion of the NEH Challenge Campaign (and some of the dedicated endowed funds may receive no donations in a given year).

The stock market and our endowment have recovered nicely from the lows reached in March of 2009, but because of volatility, the results cannot be summed up in a single number. As of 30 June 2010, the end of our fiscal year, the endowment stood at \$2,344,980.69, versus \$2,173,780.21 on 30 June 2009. As of December 31, 2009, the value stood at \$2,453,935.03. On 30 September 2010, it stood at \$2,582,304.77.

In October of 2009, our account was transferred within the Bank of America from the U.S. Trust division to the Merrill Lynch division, and in particular, its philanthropic department. The reason for the change was that the portfolio account systems at Merrill Lynch can, and the systems at U.S. Trust could not, handle our request for separate accounting for our prize endowments and our general fund. We have not yet taken advantage of this capability, because it requires some preparatory work by us to establish base values for those prize endowments, but we plan to do this over the coming year.

As we noted last year:

We have re-examined the methods by which we calculate the draws on our endowed funds. In the past, these calculations were done by lumping together all of the existing funds, then taking a draw across the board (not to exceed 5.5%). However, given that the funds are quite unequal in size, and also that the rate of expenditure differs significantly (for example, between the smaller prize funds and the larger fund that covers operating expenses), we are now tracking the actual rates of draw in each fund category. This process requires rather complex calculations that should be revisited with every new budget and reconciliation... All of the funds will still be subject to the same investment strategy.

Our new portfolio manager is Joseph Tascone (located in Utica, N.Y.), who is assisted by a relationship manager. This was Gerald (Jerry) Stonehouse (located in Providence, R.I.), but at the end of May of this year, Mr. Stonehouse announced that he was leaving, and that Paul Crosby (also in Providence) would be succeeding him. Communication with Merrill Lynch seems to be good, and after a conference call in December 2009 that included Adam Apt, the treasurer, Spencer Weart, the chairman of the finance committee, and Messrs. Tascone and Stonehouse, we agreed on an overall asset allocation for the general fund, and this was promptly implemented.

Much of the general fund is invested in mutual funds of the Columbia family of funds, which were managed by a unit of Bank of America. In October 2009, it was announced that Bank of America was selling this unit to Ameriprise. Mr. Apt enquired and was told that this should cause no change in the Society's investment portfolio, but because Bank of America earns much of its income from the Society's account through the mutual funds' management fees, this seemed puzzling. A standard document from Bank of America in April that was intended to clarify this issue and reaffirmed that there would be no change in the portfolio, still failed to make clear how Bank of America would earn a fair management fee from our account once it gave up the management of the Columbia funds. Mr. Apt will follow up with an enquiry to Mr. Crosby. Currently, there is no reason to think that the total expense ratio for our endowment is any more than the approximate 1.05% p.a. estimated last year, and may be somewhat less because its fixed component is spread over a larger base, now that the endowment's size has increased.

3. Investment Policies

The slightly updated Investment Policy Statement was approved by Finance Committee and the Executive Committee early in 2010 and has been provided to our investment manager. The new IPS was accepted by Mr. Tascone and Mr. Stonehouse, and the rebalancing of the portfolio at the end of 2009 was in accordance with the current IPS.

4. Accumulated Surplus

After some discussion among Mr. Apt, Mr. Weart, Mr. Malone, and Ms Hessels in late 2009, it was decided that if the Society's fiscal year began with a balance of \$70,000 in its Operating Reserve (formerly known variously as the "accumulated surplus" and the "contingency fund," then at no point during the year should the balance become dangerously low. So we will aim to begin and end the year with a balance of \$70,000 in the Operating Reserve (allowing, of course, for changes in the future if there is inflation or the Society's operations change significantly). If we conclude any year ahead of budget, the surplus will be noted in the Operating Reserve account and will permit us to budget these funds and reduce the draw on the endowment the following year.

5. Security

I have had a concern for some time about the security of our bank accounts. Our operations in this regard were also formally flagged last year by our auditor as a concern, though in private conversation, he said that for an organization of our small size and simplicity, our procedures were adequate and only to be expected. The problem is the degree of autonomy that the executive office has, not only in making deposits, but also in making payments. Currently, all payments must be approved by the Treasurer, but this procedure is more a formality than a system of security such as, for example, giving only the treasurer signing authority for checks after approval by the president. The Society is too large for the latter procedure (because there are too many small checks), but too small for some alternatives. One possibility is requiring the signature of the treasurer on checks above a specified size, with the approval of the president. Should this be \$3000, \$5000, or \$10,000? Mr. Weart, Mr. Apt, and Mr. Malone have discussed these possibilities without coming to a conclusion.

This is a matter that requires further discussion and resolution.

6. Budgets

The accompanying preliminary budgets for 2011, 2012, and 2013 incorporate all income and expenses of the Society, except as noted. The income and expenses not included in the General Fund budget are the Reserve Fund for restricted grant income and expenditures, and the income, administrative expenses, and contributions to the Endowment Fund; these will be reported upon separately.

The Society's accrual-based finances are based on the date for which commitment to income or an obligation is originally established, not when money is actually received or spent (for example, dues for FY2012 but invoiced and received in FY2011 are put against the FY2012 budget). In some cases, the income and expenses reported here include income earned but not collected, and obligations made but not yet met. Our accounting system operates on a cash basis, rather than the accrual basis used by the auditor, which accounts for some small discrepancies between the auditor's report and the financial statements generated in real time by the accounting

software.

For 2011, I show the preliminary budget as we set it up last October side-by-side with an updated budget reflecting the various office requests and suggestions.

For 2012 and 2013, I kept most of the 2011 values unchanged except for the specific budget requests (and the Osiris folk explicitly kept their requests level for the three years) and except as explained below. I have rearranged some budget requests. For example, you will see that, in accordance with the way we have laid out the budget in the past, I have broken out Web development, the newsletter, and annual meeting administrative costs from the Executive Office budget proposed by the office. The change is only cosmetic and does not affect the bottom line. It does, however, allow us to understand better the financing of our operations.

In the past, the net from the annual meeting was included in the overall Executive Office budget. Last October, we agreed, in the interest of transparency, to include the net as a separate line in the budget, with the assumption that the net was \$0. In conversation, though, Mr. Malone said that if the costs of Executive Office time attributed to the annual meeting were taken into consideration, there would be a loss. I have therefore shown his estimated cost of the administration of the annual meeting as a component of the administrative expense. A case could be made for the alternative of showing this as a loss generated by the annual meeting.

At the June Executive Committee meeting, Mr. Malone reported that the University of Notre Dame was picking up further expenses, and in September, he reported a further saving in the Executive Office budget. The budgets shown here, including that for the current fiscal year, have therefore been revised to reflect these lower expenses.

Last November, Council authorized the Executive Committee to raise dues by as much as 5%. After consideration of the sensitive economic environment, the Executive Committee decided in June to raise dues by only 1%. Because there is not a one-to-one relationship between changes in dues and changes in the payments from the University of Chicago Press, we requested the Press to calculate our new payment from them in light of this increase. The result is the number shown on the top line of the 2011 budget. For 2012, I assume a dues increase of 2%, and for 2013, an increase of 3%.

There have been requests for a membership category that, for reduced dues, would deliver *Isis* in only electronic form. The Executive Committee discussed this with Teresa Mullen of the University of Chicago Press, who explained that electronic delivery would not lower the costs to the Press significantly and would therefore not result in savings that could be passed along to us. If we charged lower dues for e-only membership, we would merely lower our dues revenue. The Executive Committee has therefore decided not to offer e-only delivery of *Isis* for reduced dues.

Last October, the Executive Committee assumed a draw of 5.25% on the endowment for 2011. The committee also decided to switch from using endowment values as of the end of the fiscal year to using values as of the end of the calendar year, because the committee has its mid-year meeting shortly before the end of the current fiscal year, and the December 31 value is therefore

more current than the value as of the end of the most recent fiscal year. The draw is reckoned as a percentage of the average of the ending values of the preceding three years. I have shown on the first page of the budget workbook the average of the value of the endowment on 31 December 2007, 2008, and 2009, and I have calculated the proposed draws for 2011, 2012, and 2013 as percentages of this average. Despite the lower expenses, our tentative decision not to seek greatly increased dues income necessitates large draws from the endowment than previously planned, nearing in 2013 our statutory limit of 5.5%. I should like to see the draw fall below 4% to ensure that the endowment can be maintained and can sustain our funding in the long term.

For financial sustainability over the long run, we will have to seek donations to increase the endowment, increase our dues revenue, reduce our costs, raise revenue in some other fashion, or engage in some combination of all four actions. My preferred course of action is a form of the fourth: to raise the price of attendance at the annual meeting. Fund-raising is difficult and time consuming, and it is not clear who in the Society's leadership has a talent or inclination for this. We have to be very sensitive to dues increases, because we have lost some members in recent years, though the University of Chicago Press tells us that our membership has held up much better than that of other learned societies. I don't see how we can significantly reduce our costs, and only because we have benefited to an unexpected degree from the generosity of the University of Notre Dame are we in as good fiscal condition as we are and expect to be for the next couple of years. But there is no online substitute for attending the annual meeting, and you can't borrow the library's or a colleague's copy of the experience. Spencer Weart informs me that the American Physical Society charges very low dues and earns most of its revenue from its meetings, so there is precedent for this income structure for a learned society.

7. Reserve Fund

The Reserve Fund holds special purpose funds from which the Society has decided to spend the principle. Historically, it has consisted primarily of grants given to the Society. Currently, the Reserve Fund consists of grants from the National Science Foundation and NASA. As most costs are reimbursements of funds already expended, the only balance in the Reserve Fund is a small amount originally transferred from the General Fund to maintain the necessary minimum in the checking account.

8. Endowment Fund

The Endowment Fund consists of eleven restricted funds:

Boyer Fund (used along with the Hellman Fund for support of graduate students to the annual meeting)

Current Bibliography Fund (which supports but does not fully fund the *Current Bibliography*)

Dibner Fund (which supports but does not fully fund *Isis*)

Hazen-Polsky Education Fund (which supports the Education Committee, the Hazen Education

Prize, and the Hazen Lecture in NYC)
Hazen Fund (which supports the HSS Distinguished Lecture)
Hellman Fund (used along with the Boyer fund to support graduate students)
Levinson Prize Fund (prize of \$1000 in even years)
Osiris Fund (which supports but does not fully fund *Osiris*)
Price-Webster Prize Fund (annual prize of \$1000)
Reingold Prize Fund (annual prize of \$500 with up to \$500 in expenses)
Rossiter-Women's Prize Fund (annual prize of \$1000)

As mentioned above, income from some of the endowment funds has dropped dangerously near to not being able to cover obligations as outlined above.

9. Finance Committee

Spencer Weart, a former treasurer, volunteered to take over as chairman of the Finance Committee, a post usually occupied by the treasurer, in order to ease my burden as I took over as treasurer at short notice last year. He has recently suggested that now might be a good time for him to step down from this role and for me to take over. I have benefited much from conversations with him and his steady support, and I am very glad that he is keen to continue as a member of the committee. I expect little practical change from this point as a result of the transition.

Respectfully submitted,

Adam Jared Apt, CFA
Treasurer

Attachments:

FY11 Budget and FY12 and FY13 Projected Budgets (rev. 10/04/10)