TREASURER'S REPORT TO COUNCIL AND OFFICERS
HISTORY OF SCIENCE SOCIETY

4 October 2011

1. Introduction

The Society remains on a firm financial footing, and we continue to move in small increments toward more clarity of oversight of our total financial picture and of our financial needs.

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 operating 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. Last year, we began to consider the possibility of increasing revenue from the registration fees for our annual meeting, as a way of keeping down dues increases, given that conference registration seems to be less sensitive to increasing prices than is membership. This year's registration fees reflect just such a change. We will study the results after the conference (which, although held in 2011, will be in fiscal year 2012) and try to judge whether registration numbers were affected.

At the end of 2010, Dr. Weart asked if he might step down as chairman of the finance committee, a role he had assumed in order to ease Dr. Apt's transition into the role of treasurer. He remains on the committee, and Dr. Apt now serves as chairman of the finance committee, as has been customary for the Society's treasurers.

2. Endowment and Draw Calculations

As the treasurer must always note at the outset, 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. Dues revenue alone cannot sustain our operations. Donations to the general endowment have not increased since the completion of the NEH Challenge Campaign. At last year's meeting of the Finance Committee, there was some discussion of development activities, and this, I hope, was the first step toward what might be either a capital campaign or a more sustained and continuous effort to solicit contributions.

In calendar year 2010, the stock market and our endowment recovered nicely from the lows reached in March of 2009. As of June 30, 2010, the endowment stood at $2,344,980.69. As of December 31, 2010, the value stood at $2,740,243.38, and as of June 30, 2011, the value stood at $2,896,218.68. As of this writing, however, the stock market is down considerably from its value at the end of the last fiscal year.

Our portfolio continues to be managed by Bank of America Merrill Lynch, to which our account was transferred in 2009 because Merrill Lynch has the accounting software that can track our restricted fund accounts, including our prize funds. We still have not taken advantage of this capability, because it requires some preparatory work by us to establish base values for those accounts, and it is incumbent upon me, as treasurer, to initiate this process. During the annual audit of the Society's accounts, in August 2011, we did, however, begin to progress toward an implementation.

As we noted in 2009:

> 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 portfolio manager continues to be Joseph Tascone (located in Utica, N.Y.), who is assisted by a relationship manager, Paul Crosby (based in Providence). Our portfolio is managed to a model established for institutional clients assigned to the risk tolerance category upon which we agreed. Communication with Merrill Lynch is adequate, but has been better. After numerous requests for an updated contract, we have at last received the form.

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 of 2009, it was announced that Bank of America was selling this unit to Ameriprise. I 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. I have made enquiries without producing a clear answer, but so far, there is no indication that the cost of management of our endowment will increase.

3. Investment Policies

There has been no change to our investment policy statement nor to Bank of America Merrill Lynch's asset class allocation policy in the last year.

Since our last report, I have, for my own business purposes, attempted to come up with a long-term expected return on the U.S. stock market. My best estimate of the nominal rate of return (including inflation), based on research by the economist Bradford Cornell, is about 7% per annum. Given that our endowment is allocated in such a way that very roughly 70% is in stocks and 30% in bonds, and assuming a long-term return of 3.5% on bonds, we are then looking at a nominal return of about 6% on the endowment before management fees, which are around 1%. It's probably fair to shade this up a bit because of other aspects of our asset class allocation. That suggests revising the nominal rate of return to very roughly 6.5%. Converting this to an average annual return (using a standard mathematical method), we get 7.5%. This is the typical return one might expect in a year, as distinct from the growth rate over time. Right now, there is, among both economists and investment professionals, sharp disagreement over what our inflation expectations should be, though the financial markets themselves are predicting very low inflation. It may be fair, however, to allow 2.5% for the amount of inflation implicit in our forecast, in which case, we can expect our endowment to average, over the long term, about 5% per year in real value, before fees. This, then, minus fees, or about 4%, should be the cap on our annual draw on the endowment if we do not want to deplete it, even though our formal cap is 5.5%. As the accompanying budgets show, if the endowment holds its value, our projected draws for the next three years will remain below 5%, but we must continue to budget with care and mind the costs of the annual meeting.

4. Operating Reserve

We continue to 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 if 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 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. As a step toward greater security, we have recently instituted the requirement that the treasurer countersign all checks for amounts greater than $4000. Checks for smaller amounts are too numerous to make countersigning practicable. The need for two signatures above the $4000 threshold is now printed on our checks.

The Society keeps its books on QuickBooks Online, which allows the treasurer remote access to the books without going through the executive office; this permits an independent check on the Society's financial records. The treasurer also has access to the online bank accounts, which allows for further checks. In addition, the HSS Operations Manual provides details on extra security, such as monthly account reconciliations and payment approvals.

6. Budgets

The accompanying preliminary budgets for FY2012, FY2013, and FY2014 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 FY2013 and FY2014, I kept the FY2012 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 and the newsletter costs from the Executive Office budget proposed by the office and made them separate line items outside the EO budget. 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 past years, the net from the annual meeting was included in the overall Executive Office budget. Starting with the FY2011 budget, 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, Dr. Malone said that if the cost of Executive Office time attributed to the annual meeting were taken into consideration, there would be a loss. He included this amount in his Executive Office budget, and I have presented this as a line item within the Executive Office budget. Other Executive Office expenses are largely routine and not necessarily deserving of the attention of the Executive Committee (except when salaries are reviewed).

I have built in no increase in revenue from the University of Chicago Press in FY2012 and assume a small increase in FY2013 and FY2014 as a result of increasing individual dues, as indicated in the notes. These increases will have to be negotiated with the Press. (Changes in institutional subscription rates have no effect on the payments by the University of Chicago Press to the Society.) Given that last year, Council voted to approve a dues increase of up to 5%, which was not implemented, I expect no difficulty in gaining approval for these smaller increases.

In 2009, the executive committee 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 calculated the draw for FY2012 using actual year-end values for the trailing three calendar years. I then assume that, in the next two years, there is no growth of the endowment, so that it decreases each year by the amount of the previous year's draw. This is, I believe, the most conservative assumption for the investment outlook that I can justify.

I assume a small draw on the Operating Reserve for FY2012, as budgeted in the previous year, but none thereafter. This will require a check to confirm that the initial balance will remain at $70,000, as explained earlier. The Operating Reserve in 2010 exceeded our requirements, and this draw, as well as the draw in the previous fiscal year, FY2011, was part of a plan to liquidate the excess.

You will see that the budgets are not balanced, but they are very nearly so. I expect further adjustments at future executive committee meetings, so fine tuning of the budget seemed unnecessary in advance. The balancing normally consists of fine adjustments to the planned endowment draw. The discrepancies between income and expenses amount are hardly different from rounding errors.

Overall, the draws on the endowment for the next three years appear to be reasonable and compatible with the sustainability of the endowment. Because of cost savings, especially from the relationship with Notre Dame, these draws are lower than we expected them to be last year.

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 ($1000), and the Hazen Lecture in NYC)
Hazen Fund (which supports the HSS Distinguished Lecture in the form of a $1000 honorarium)
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)

We have been working toward being able to provide the current balances in these funds. In the past, we have relied upon the auditor's estimates, but in this, our transition year to a new auditor, the values are still unsettled. We plan to provide these values again in the future , and more reliably, once they are entered into the accounting system.

9. Auditor

The executive office, after securing bids from three firms and in consultation with the treasurer, has hired the South Bend accounting firm of Jurgonski and Fredlake, which has extensive experience with non profits. Our previous auditor, Lon Stafford, has graciously agreed to work with the new auditors in the transition and to perform quarterly write ups so as to expedite the annual audit. The audit took place on 15 to 17 August, and the auditor's report will be provided separately.

Respectfully submitted,

Adam Jared Apt, CFA
Treasurer

Attachments:
FY12 Proposed and FY13, FY14 Projected Budgets (rev. 8/11), FY2011 budget reconciliation