TREASURER'S FY 2012 REPORT TO THE OFFICERS AND COUNCIL OF THE HISTORY OF SCIENCE SOCIETY

30 October 2012

1. Introduction

The Society remains on a firm financial footing, but we must continue to keep a close watch on future expenses. We have made great progress toward more clarity in our budgeting. This has contributed to better oversight of our total financial picture and of our financial needs, though more can still be done.

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, after discussion of ways to increase revenue without discouraging membership by raising dues, we increased the registration fees for our annual meeting. This seemed reasonable and practicable given that conference registration seems to be less sensitive to increasing prices than does membership. To judge from the reconciliation of the FY 2012 budget, this seems to have worked out as we hoped.

2. Review of FY 2012

Our budget reconciliation for FY 2012 has two striking peculiarities. First, it appears to show that we finished the year with a substantial deficit of -$34,618. But a look at the reconciliation of the income forecast shows the second peculiarity: we took hardly any of the planned draw on the endowment was taken in FY 2012. This draw will be taken during the current calendar year. If we add back the planned draw on the endowment, we find a surplus of $53,979. A very large portion of this surplus, $20,000, is accounted for by a delay in incurring the expense of redesigning our Web site, an expense that has now been pushed into FY 2013. Beyond this, there was unexpected income from the annual meeting and substantial savings in a number of line items, including the production of the newsletter, the publication of *Osiris*, Web hosting, executive committee travel, and overall executive office costs.

3. Budgets

The accompanying workbook with the actual budget for FY 2013 and the preliminary budgets for FY 2014 and FY 2015 incorporates 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 FY 2013 but invoiced and received in FY 2012 are put against the FY 2013 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. Note, however, that draws on the endowment are recorded when they actually occur. (As mentioned in the preceding section, on the budget reconciliation for FY 2012, the draws scheduled for that fiscal year were not taken then, and are also not recorded as having been taken then.)

For FY 2014 and FY 2015, I kept the FY 2013 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. Because the editorship of *Isis* is about to undergo a transition, we do not have good figures for FY 2014 and FY 2015; I have therefore simply copied the figures for FY 2013. I have rearranged some budget requests. There have been some cosmetic changes to the presentation since I last presented the budget. Most of these are for clarity. One, the addition of a column to the FY 2013 worksheet showing the corresponding actual (but unaudited) figures for FY 2012, should also help in judging how realistic the budgeted values are. In June, the Executive Committee voted to cut slightly the travel budget for the *Critical Bibliography* team. Also, for FY 2014 and FY 2015, we are adding a line item for the meetings of the separate committees (to cover their lunches), which have hitherto been silently covered by the Development budget, which is not an appropriate characterization.

Another innovation this year is the inclusion in the budget workbook of separate worksheets for all the individual budgets: for *Isis*, *Osiris*, the *Critical Bibliography*, and the Executive Office. Previously, these had to be sought separately; now all the information is in one place.

In past years, the net from the annual meeting was included in the overall Executive Office budget. Starting with the FY 2011 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). These can, however, now be seen in the office's worksheet within the budget workbook. I would argue that the apparent loss on the annual meeting, once the direct costs and the administrative costs are added together, is not a cause for concern. One very important reason for funding an executive office in the first place is that it is needed to organize and support the annual meeting.

Members of the Finance Committee have asked about the total cost of running the executive office, a question that arises because the budget does not reflect the full cost. The University of

Notre Dame covers a significant portion of the cost, including employee benefits. This is a good question, and it would be appropriate to have the answer should it ever be necessary for the Society to assume the total cost of management, or to renegotiate an agreement to host the office. It may not be necessary to include what amounts to income in kind and related expenses in our budget, but I hope to be able to produce a separate document from time to time that give the total financial picture of our Executive Office.

I assume a small increase in dues in FY2013 and FY2014. Given that Council voted, in its calendar year 2010 meeting, to approve a dues increase of up to 5%, which was not implemented, the Executive Committee approved and implemented the increase for FY 2013, and I expect no difficulty over the second small increase. Together, the two increases are less than 5%. I have not budgeted a dues increase for FY 2015. The University of Chicago Press has been formally notified of the increase for FY 2013. The increase for FY 2014 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.)

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 FY 2013 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.

For FY 2012, we budgeted and took a draw of $25,000 from the Operating Fund. I assumed no such draw thereafter. The reason was that we were carrying a larger cash balance than we needed. Dr. Malone and I have estimated that if we begin the fiscal year with a cash balance of at least $70,000 in the Operating Fund, our ability to meet our financial obligations will not be impeded or threatened. The Operating Fund in 2010 exceeded our requirements, and the FY 2012 draw, as well as a draw in FY 2011, was part of a plan to liquidate the excess.

A draw of $5000 from the Wells Fargo account, which was designated specifically for the redesign of the Web site, has been rolled over from FY 2012 to FY 2013, because no costs were incurred by this project last year. We expect to fund that project in the current year.

As I argue below, we should keep our draw on the endowment below 4% annually. As the FY 2013 budget now stands (after a couple of revisions), the scheduled draw is 4.16%. This, I am confident, will turn out to be a vast overestimate. The problem is only one of timing. The reason is that, when the budget was drawn up, I was expecting to roll over the $25,000 draw on the Operating Fund from FY 2012. Because, however, we did not take the scheduled draws on the General Endowment and the Dibner Fund, the draw on the Operating Fund was needed in FY 2012, as originally budgeted. Now that we plan to take last year's draws on the General Endowment and the Dibner Fund in the current fiscal year, we are more than likely to finish the current year with a cash surplus in the Operating Fund. Either we will take less than the budgeted draws for FY 2013 on the General Endowment and the Dibner Fund, or we will apply the surplus cash and reduce the draws for FY 2014. We should have a clearer picture of our cash position come March, when I will begin to revise the budgets for FY 2014 and FY 2015.

I conclude by noting the considerable uncertainty in the budgets for FY 2014 and FY 2015, the consequence primarily of not yet knowing who the next editor of *Isis* will be and at what institution. Secondarily, there is always a large measure of uncertainty in the costs of the annual meetings and the revenue (which comes mainly from the registration fees), even in the calendar year in which it takes place and before the fiscal year budget is frozen.

4. Operating Fund

We continue to aim to begin and end the year with a balance of $70,000 in the Operating Fund (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 Fund account and will permit us to budget these funds and reduce the draw on the endowment the following year.

5. 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 the last two years' meetings of the Finance Committee, there was some discussion of development activities, and this, I hope, is a first step toward what might be either a capital campaign or a more sustained and continuous effort to solicit contributions. A larger endowment should make us more secure in the event of a sustained decline in membership or a subsequent drop in the value of the endowment as a result of a market decline.

In calendar year 2011, the stock market and our endowment had an unnerving trajectory. The market dropped sharply in the third quarter of the year, then began to recover in the fourth quarter. As of December 31, 2011, the endowment stood at $2,618,510.25. During the first quarter of 2012, the market continued to rise, and as of June 30, 2012, the value of our endowment stood at $2,799,710.59.

Our portfolio continues to be managed by Bank of America Merrill Lynch, to which our account was transferred in 2009 from U.S. Trust, also owned by Bank of America, because Merrill Lynch has the accounting software that can allocate our pooled endowment funds to the individual named endowments, and thereby to track them individually. (I have been told that there are plans afoot to make this accounting software available to U.S. Trust.) We still have not taken advantage of this capability, because it requires some preparatory work by us to establish basis values for the general endowment. During the annual audit of the Society's accounts, in August

2011, we began to progress toward an implementation. Nothing further has been done. We seem now to be held up by incomplete records of the initial values, and this will necessitate legal services and going to court to set the basis values in the absence of documentation. I would like to have this completed by the time of my next report. Dr. Malone has now (October 2012) initiated this process with a preliminary legal consultation.

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. As I have reported before, communication with Merrill Lynch is adequate, but could be better; in particular, it could be more prompt, and without need of repeated reminders. There was recently a certain amount of trading in our portfolio, consisting of the sale of most of the Columbia mutual funds and their replacement. I believe that this is the result of the ending of an agreement between Bank of America and Amerprise, to whom B of A sold the Columbia funds family a couple of years ago. I intend to find out more in my next annual call with our portfolio manager.

Some time ago, I calculated the total annual cost of management of our endowment, and discovered that it came to a little over 1% of assets under management, which seemed reasonable. In view of the recent turnover in our portfolio, it is probably time for me to repeat this exercise. It’s not a simple calculation, because the management fees for each fund have to be correctly reckoned, and then weighted by the proportion that each fund represents of the total endowment. This, of course, is a constantly changing figure. I intend to complete this exercise by the end of the year, and I will report the results back to the Executive Committee and the Finance Committee.

6. 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. I have completed and returned to Merrill Lynch a form that confirmed that we wish to maintain the same asset class allocation policy that they have assigned to us, given our previous conversations and our investment policy statement.

As I reported last year, for my own business purposes, I attempted to come up with a long-term expected return on the U.S. stock market. My best estimate at the time of the maximum possible 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 maximum 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 average 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 on what our inflation expectations should be, though the financial markets themselves are forecasting 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. But bear in mind that the growth rate of 7% with which we started is not the expected growth rate, but an estimate of the maximum possible growth rate; we should expect something lower. If we subtract 1% for fees from the 5% estimated maximum average return, we're left with about 4% Thus, 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%, and for safety, the figure should be less.

As the accompanying budget workbook shows, our projected draw for FY 2013 exceeds this cap, but I have explained above that this high level is an artefact of timing and not a cause for concern. The scheduled draws for FY 2014 and FY 2015 are well below the cap. I still believe that the easiest way to deal with increasing expenses is to raise the conference registration fees rather than dues, but in the long run, we will have to add to our endowment, especially if the Society decides to expand its activities in ways that do not directly generate sufficient revenue to cover their costs.

7. 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 in calendar year 2010, 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, two years ago we 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.

8. 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.

9. Endowment Fund

The Endowment Fund, which is exclusive of the General Endowment, 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)

The balances for these funds as we currently calculate them appear on the draw calculation sheet provided, and will be confirmed by the auditor in anticipation of the Council meeting.

10. Auditor

Last year, the Executive Office, after securing bids from three firms and in consultation with the treasurer, hired the South Bend accounting firm of Jurgonski and Fredlake, which has extensive experience with non profits. They performed last year's audit for FY 2011 and this year's for FY 2012. The audit took place on 20 to 23 August.

Respectfully submitted,

Adam Jared Apt, CFA
Treasurer

Attachments:
Workbook with the Final FY 2013 Budget, and the Projected Budgets for FY 2014 and FY 2015 (rev. 7/12); Workbook with budget reconciliation for FY 2012