TREASURER'S FINAL FY 2016 REPORT TO THE OFFICERS AND COUNCIL OF THE HISTORY OF SCIENCE SOCIETY

27 October 2016

1. Introduction

With the conclusion of the 2016 fiscal year, the Society is, for the first time during my eight-year tenure as treasurer, looking toward an entirely new financial regime. The change is attributable, in very large measure, to the anticipation of a fund-raising campaign. Because, at this moment, the Executive Committee has not proposed and Council has not yet authorized such a campaign, much of what I write about our financial outlook is provisional, though the FY 2016 results are real enough, and the FY 2017 budget is what it is. To some extent, also, the changes in our financial status reflect the beginning of the implementation of our new strategic plan before the raising of the funds that will underwrite its initiatives.

A non-profit organization, even one composed almost entirely of volunteers, cannot expect to raise money without spending money. If, as expected, the Society undertakes a fundraising campaign, it will have to put up money initially to pay for professional guidance, and it will continue, as money begins to come in and for the duration of the campaign, to pay for that guidance, for travel, and for incidental expenses, like the printing of materials to be given to prospective donors. In reading the FY 2017 budget and the preliminary budgets for FY 2018 and FY 2019, you should note that only $15,000 has been allotted to “Development” in the first year, and nothing in the next two years. This is unquestionably wrong, but especially for the next two years, we have no idea what numbers to specify. We will clearly be spending much more money than is budgeted. The budgets are therefore most useful for understanding the individual line items, but not the sum of the whole.

In all my reports, I have said that, in my view, our “bottom line” is the annual percentage draw on our endowment, and that I feel, because of my expectations of market returns, that this draw must be below 4% to be sustainable, and the lower the better. We should, however, expect to exceed that draw, perhaps by a large amount, for the next few years. The goal of the campaign, in terms of dollars, should be a total endowment that is sufficiently large that at its completion, the Society can support its activities with a draw of less than 4% per year. (This implies, of course, that, in order to continue to fund our existing activities, we need to raise funds not only to cover our new initiatives, but also to replace the monies advanced to initiate the campaign. More money, beyond these amounts, would be preferable, in order to provide more financial security for the future.)

Our budget reconciliation for FY 2016 shows that we overspent our budget by about $131,000. This is seriously misleading, however, because we did not take the budgeted draw of $93,800 on the Operating Reserve. Had we done so, the loss for FY 2016 would appear as only $37,200. There are three main reasons for the loss: The expenses associated with the annual meeting were much more than budgeted—this was the largest discrepancy; our annual audit for FY 2015 cost us more than double what we had anticipated; and *Isis* incurred costs for copyediting and proofreading beyond what we expected. Against this should be weighed our not having used the full $15,000 budgeted for the beginning of our fundraising campaign. I will cover each of these in its section of this report.

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. The continuing strong U.S. stock market allowed the size of the endowment to remain more or less level in calendar year 2015. (The budget shows, and relies upon, the value of the total of endowment funds as of 31 December of the past three years.) In order to eliminate intra-year exchange-rate risk (which arises from our funding the editorial office in the Netherlands), and thereby to ease our financial planning, we transfer the full annual payment to the Descartes Centre for the editorial office at the beginning of each fiscal year, rather than making quarterly or semi-annual payments. The editor, Dr. Cohen, has requested, however, that the payment made personally to him be made in arrears, so that, were anything to happen to him in the interim, the Society would not have to go to any effort to recover its payment. Because this will make his compensation subject to exchange-rate risk at the time of budgeting, there is no great reason, except the minor transaction fees, not to make it as a series of quarterly payments in arrears, instead of an annual sum. This monetary payment is an alternative to the compensation given to his immediate predecessors as editor, which was in the form of a course release from their home institutions. This is because Dr. Cohen has retired from teaching. Because the payment to the Descartes Centre is being made all at once, in advance, an amount of money equivalent to some proportion of this should be paid back into the endowment as funds are received quarterly from the University of Chicago Press. In the past, we would normally count on the reverse, paying out some proportion of our receipts from Chicago to the editorial office.

In early June 2015, the Executive Committee voted to present to Council a proposal from the University of Chicago Press for the renewal of our contract with them. Council then approved this new contract at its November meeting. The new arrangement under the terms of this contract took effect on 1 January 2016, halfway through the fiscal year. The contract specifies increased payments by the Press to the Society starting at a level above its previous payment to us, and with, typically, 3% increases taking effect at the start of each subsequent calendar year. The budget workbook therefore shows, for each fiscal year, a receipt from the Press of half the payment of the current calendar year plus half the payment of the next calendar year.

In the summer of 2016, after the close of FY 2016, we learned of a major unexpected expense. As Dr. Malone was winding up our relationship with the Philosophy of Science Association (PSA), who formally notified us in FY 2014 of their intention to end our contractual arrangement, he learned that they would hold us to the terms of our contract with them, whereby we had to share equally with them any surplus generated by our joint annual meetings. Although, in fact, there was never a surplus if the full administrative costs of the annual meetings were taken into account, the contract between us and the PSA stipulated that their payments to us for two quarters of the years of our joint meetings were their full coverage of their share of the administrative costs. With that artificial reckoning of the cost of administration, the meetings generated a surplus from the PSA's share of revenue and expenses. Clearly, the contract had not been drawn up to allocate costs appropriately, but there is nothing to be done about it now. As a result of this, and after continual discussions between Dr. Malone and the PSA's representatives, it appears that we owe them about $35,000. The timing of this payment has yet to be determined.

2. Risks to the Society's Finances

There are five risks to the Society's finances. I have listed these before, but I am changing the order this time, to reflect what I believe to be their importance. Here they are, in decreasing order of impact.

First, there is the cost of the fundraising campaign. The purpose of the additional capital should be, as I wrote above, to support the initiatives specified by the strategic plan. The strategic planning committee has estimated—and this is a very rough estimate—that these initiatives would cost about $125,000 per year. To generate that income through investment return alone would require additional endowment capital of between $3,125,000 (on the optimistic assumption of an annual draw of 4%) and $4,166,667 (on the more prudent assumption of an annual draw of 3%). To be sure, that estimate was established before we knew what the increased payments from Chicago would be, but it overwhelms the size of those increases. There may be ways that we can explore to generate income other than drawing on the endowment, but because we are a non-profit organization, those will necessarily be limited. As I noted above in my introduction, in order to cover the cost of the campaign, the total amount raised will have to be much greater than either target. The risk of a shortfall in fundraising could be mitigated by scaling back implementation of the strategic plan's new initiatives. A closely related risk that cannot be reduced is that of the campaign costs that have to be covered by current income rather than monies raised. As I noted above, I do not as yet have a way to estimate these.

Second, a perpetual risk is the financial arrangements for the annual meeting. The revenues and costs of the annual meeting become clear only as we draw much closer to the date of the meeting, which is why the budget contains only big, round numbers for it, with no details. The site of this year's meeting, Atlanta, may be somewhat less expensive a destination than our last three (San Francisco, Chicago, and Boston), but it may also draw fewer attendees. Our Executive Office has "muscle memory" that should make the meeting management relatively smooth.

Third, and just over the horizon, is the very significant cost of the *Isis* office. Dr. Cohen has been adamant that he will not bid to renew his editorship when his current term ends (at the end of FY 2019). It is entirely possible that the location of the next editorial office will cost the Society considerably more than the current one. There are, however, some grounds for hope that we may be able to continue with something like our current arrangement. You will see that the preliminary budget for FY 2018 includes travel expenses for the Committee on Publications, in connection with their identifying a successor.

Fourth, there is the ever-present danger of a fall in the stock market, which would drive up (all else being the same) our percentage draw on the endowment, at just the time when we have scheduled what are already large draws.

And fifth, the exchange rate could turn against us before we transfer funds to the Netherlands. But in comparison with the other risks, the magnitude, in dollars, of even a very bad realization of this risk would be small.

3. Finance Committee

At the start of FY 2016, the Finance Committee was as it had been the previous year: Hamilton Cravens, Richard Kremer, Karen Parshall, Richard Sorrenson, and Edith Dudley Sylla. Dr. Parshall remains the longest-serving member apart from the treasurer. We greatly lament the loss of Dr. Cravens, only about a week before our November meeting. He and I had even discussed the possibility of his conferencing into the meeting after his major surgery. It was in the course of that surgery that he died. In the spring, we were joined by Dr. Wendy (Jia-Chen) Fu.

As I have stated before, I am pleased with the level of conversation among the committee about the Society's budget. We are also looking harder at the management of the endowment. The committee has charged me with looking into the possibility of an alternative arrangement, possibly with Vanguard, that might save us money on management fees (not that the fees that we pay U.S. Trust are out of line with investment industry practices), although possibly with a more "manufactured" portfolio.

I will be stepping down as treasurer on December 31, after eight and a half years in the role. I have been in increasingly regular communication with my newly elected successor, Dr. Gwen Kay, who is rapidly becoming familiar with our operations. I have offered, and she has accepted my offer, to continue to serve on the committee. She will, of course, attend the annual meeting of the Finance Committee in November.

4. Revenue from Dues

As I have written in earlier reports, the Society, like other scholarly organizations, has seen its individual membership slowly decline. As of this writing, the size of the decline is not a cause for concern, and indeed, in the most recent report from the University of Chicago Press, our membership levelled off. Institutional membership—it would be more accurate to call it institutional subscriptions to *Isis*—has held up. Unlike the dues from individual members, the revenue from institutions does not in any direct way flow back to the Society; that is, we cannot increase revenue by increasing institutional dues. Nonetheless, it was the health of institutional membership that allowed the University of Chicago Press to offer the Society the more generous terms of our new contract.

With advice from the University of Chicago Press, we have decided not to increase individual membership dues for the coming year.

The purpose of a fundraising campaign, if there is one—and I repeat that this has not yet been decided—will be to fund the initiatives in the strategic plan, not existing costs of operations. If these existing costs increase, the Society will therefore have to increase its income from sources other than investment returns. One way would be through increased dues. As I have stated before, however, I believe that the easiest and fairest way to cover increasing expenses is to raise the registration fees for the annual meeting rather than dues. For this to benefit the Society, however, we would have to eliminate the rule that surpluses from annual meetings are rolled over into subsequent annual meetings and the coverage of travel subsidies. With the support of the Finance Committee, I hope to have this on the agenda of Council for its November 2016 meeting; failing that, I hope that Council will rescind the rule at its next meeting.

5. Endowment and Draw Calculations

Dues revenue alone (as realized through the payments from Chicago) cannot sustain the Society in its current form. The most important source of revenue after dues is the Society's combined endowment funds (the "endowment"). As the treasurer must always note at the outset of his report, 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. Donations to our general fund have not increased beyond a steady trickle—but thanks to the devotion of our members, it has indeed been steady—since the completion of the NEH Challenge Campaign.

At the start of FY 2016, on the morning of July 1, 2015, the endowment had a value of \$3,361,965.83. At the end of the calendar year, on 31 December 2015, it stood at \$3,261,606.38. At the end of FY 2016, on 30 June 2016, it stood at \$3,301,355.90.

As I noted in my introduction, I continue to use our annual percentage draw on the endowment as the single best measure of the Society's financial health. If the draw is sufficiently low, then, if we assume that dues receipts at least keep pace with inflation, the Society can sustain itself indefinitely.

I have repeatedly stated, and without any discernible opposition, that the Society should plan to limit its budgeted draw from the endowment to less than 4% annually, and the lower the better.

By the Society's by-laws, it is permitted to draw up to 5.5%. I base this lower maximum on my professional judgment that the long-run real rate of return on the U.S. stock market (that is, the return after inflation is subtracted) is very likely to be no more than 4%, and, given that our portfolio, in order to moderate investment risk, is diversified into other asset classes (primarily bonds) that can be expected to have a lower rate of return, even a draw of 4% will likely lead, over a long span of years, to a noticeable diminution of the real value of the endowment. Some endowment managers are still assuming that they can draw a higher percentage, as they did in the past, and foundations are required by federal law to spend at least 5% of their endowments' value annually, but I believe that my view is actually well within the mainstream of professional investment thinking. There is a growing body of professional writings supporting the less buoyant forecasts. For the curious, I can provide references from the current literature of finance.

For the coming fiscal year, the projected draw is about 6.3%, and for the following two fiscal years, for which we haven't even budgeted any funds for fundraising, the draws are close to 6%. These estimates are based on the assumption that there will be no growth in the endowment through investment returns.

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, but no date has been set for this.) We still have not taken advantage of this capability. A continuing problem since I became treasurer is that we did not formally establish the basis value of the general (unrestricted) endowment. The problem relates to the loss of early records of the gifts to those endowments. We believe that, as of the most recent audit, we have the necessary values, and it may soon be possible, at long last, to track the values of the funds individually.

All the endowment funds continue to be managed collectively and thereby to earn the same rate of return. The problem is only one of accounting. For legal reasons, we have to maintain the value of contributed principal to the restricted funds and to comply with the wishes of the donors.

As I noted above, I have been charged by the Finance Committee with investigating the possibility of having our endowment managed professionally for a lower fee.

In FY 2014, we established a new endowment fund, the Elizabeth Paris Endowment for Socially Engaged History and Philosophy of Science, in memory of a younger member of the Society who had an untimely death. The purpose of this endowment reflects one of her concerns. As of May 31, the Society had raised more than $85,000 toward its goal of $100,000 to fully fund the endowment, which will pay for a regular public event. The first event took place in November 2014, but the first budgeted draw on this endowment, for only $500, appears in the budget for FY 2017.

The investment staff servicing our portfolio changed halfway through the fiscal year. Our portfolio manager as of August 2015 is Andrew H. Dana, and our relationship manager at U.S. Trust is now Geraldine M. Smith, who began to work with us just around the time of our 2014 annual meeting. Our portfolio is managed to a model established for institutional clients assigned to the risk tolerance category upon which we agreed.

Several years ago, I calculated the total annual cost of management of our endowment, including the fixed annual fee and the expense ratios on the funds, and I discovered that it came to about 1.09% of assets under management, which seemed reasonable. Two years ago, Bank of America / Merrill Lynch sent us a statement with an explanation of their new fee structure, and as I promised to do in the Treasurer's Report for FY 2012, I repeated the exercise, in March 2013. My conclusion was that we were then paying about 1.16% of assets under management annually. (The percentage is not fixed, as different funds carry different expense ratios, and the relative proportions of the funds in the endowment portfolio will vary over time.) As an investment advisor myself, I regard this fee as a little high, especially for a not-for-profit organization, but not beyond reason; I know of managers who charge more. I asked for the views of the Finance Committee; there were no objections, and a couple of comments saying that it seemed reasonable.

Since early 2013, we have had online access to our portfolio account. The Executive Office and I have the login credentials, but for reasons of security, I have not distributed these more broadly to the Finance Committee. I have also set up access to the site through the portfolio accounting system used by my private investment management firm. This, unlike the official site, can present performance figures, but only roughly, and only from the time it began to collect data, just before the start of FY 2014. (The roughness of the performance calculation is the result of the system's having access to the investment values at second hand; my clients usually receive more accurate figures.) Also, because it is an entirely separate platform and does not reveal our account number, security is a lesser concern, and I have shared the login credentials with the Finance Committee (with an updated password late in 2014). We can always get accurate performance figures by special request from Merrill Lynch, and I make such a request every year in preparation for the November meeting of the Finance Committee. Their site shows the daily positions in our portfolio, as does the site of my accounting system, but the latter with a day's lag. My accounting system has one quirk that I cannot explain: It does not show the cash position of our combined endowments, which is normally several tens of thousands of dollars. The total value of the combined endowments shown by the system is therefore noticeably smaller than the actual value. (I have not seen this problem in its reports on my clients' portfolios.)

I have been downloading PDFs of all our statements to my computer, and I can share these statements with any member of Council or the Finance Committee who requests them.

6. Investment Policies

In mid-June 2013, Merrill Lynch sent us a letter stating that it would no longer send us paper copies of our monthly statements. As I was reminded by Dr. Kremer, our Investment Policy Statement (IPS) specifies that all members of the Finance Committee should receive these statements monthly from the manager. Given that it is probably unrealistic to expect Merrill Lynch to make an exception to their new policy for us, I have modified the IPS to reflect this. I have made a few other minor changes to the IPS. In FY 2016, this new version was approved by the Finance Committee and submitted to Council, which ratified it at its June (teleconference) meeting. I then submitted it to Mr. Dana, our portfolio manager. As this was happening, Mr. Dana sent me the standard investment policy statement used by Merrill Lynch for clients who match the risk tolerance profile that I selected from among the standard risk tolerance profiles that they offered. This was not incompatible with our own IPS, except for some minor differences in the position limits placed on a couple of asset classes. I went over these differences with him, which he said would not be a problem. It was clear that his employer wanted us (and all clients) to sign off on one of these standardized IPS forms. I asked that our own be respected, and he said that this, too, would not be a problem.

Beyond these matters, there have been no further changes to our investment policy statement nor to Bank of America / Merrill Lynch's asset class allocation policy in the last year.

As an investment professional, I do not time the stock market. Repeated observation convinces any objective and self-reflective investment analyst that this is just another road paved with good intentions. Nonetheless, I must note, as I did last year, that the U.S. stock market seems to be at a high level with respect to reasonable valuation measures, and I believe that we do not face the prospect of continuing high returns. In light of this, the expectation of even a 4% annual real return to our endowment over the next decade or more must now appear optimistic.

7. Operating Reserve (or Fund)

We continue to aim to begin and end the fiscal 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 fiscal year ahead of budget, the surplus appears in the Operating Reserve account and allows us to budget these funds and reduce the draw on the endowment the following year. That may partly explain the large budgeted draw on the Operating Fund for FY 2016, though, as noted earlier, the main reason is a matter of timing. It turns out, however, that we did not take the budgeted draw on the Operating Reserve during FY 2016. As noted earlier, at the end of Section 4, we are currently restricted in our use of most of this excess in the operating reserve, and I hope to have this restriction lifted.

I assume no draw from the Operating Reserve for FY 2018 and FY 2019.

8. 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, that auditor said that for an organization of our small size and simplicity, our procedures were adequate and only to be expected. The problem has been 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, in FY 2011, we instituted the requirement that the treasurer countersign with the executive director all checks for amounts $4000 or greater. Checks for smaller amounts are too numerous to make countersigning practicable. The requirement for two signatures for the $4000 threshold is now printed on the checks for the main operating account.

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. I have seldom made use of this, though I have used it from time to time to check the size of our Operating Reserve. The online access enables not just the treasurer to check the accounts, but also the undergraduate intern to monitor the registration fees for the annual meeting. (The undergraduate cannot change the values in the accounts.)

In September 2015, the Executive Office retained the services of a bookkeeper, thereby relieving the professional staff of a time-consuming and unproductive burden. The bookkeeper also now reports directly to the treasurer monthly, independent of the professional staff, with accounts of income and expenses for the month, and the values of the holdings of our various accounts. I have been reviewing these as they arrive. Further, Dr. Malone has instituted a procedure whereby the bank that holds our operating funds (Wells Fargo) automatically notified me of each withdrawal and its amount. To some degree, these procedures ought to provide an additional check on the Society's finances.

We intend to institute one further safety procedure, for our endowment. We will arrange that the investment manager not proceed with any withdrawals unless they have the authorization of two officers of the Society.

9. Budgets

The accompanying workbook with the final budget for FY 2017 and preliminary budgets for FY 2018 and FY 2019 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. These are the budgets that were approved by Council at its June meeting.

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 2016 but invoiced and received in FY 2015 are put against the FY 2016 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.

In past years, the net from the annual meeting was included in the Executive Office budget. Starting with the FY 2011 budget, we agreed, in the interest of transparency, first to include the net as a separate line in the Society's budget, with the assumption that the net was $0, and subsequently to show the income from and the expense of the annual meeting separately within the Society's budget. In conversation, though, Dr. Malone said that if the true cost of Executive Office time attributed to the annual meeting were taken into consideration, there would be a loss. We now present this cost as a line item within the Executive Office budget. The assumption through FY 2016, on Dr. Malone's advice, was that about 50% of the office's time was devoted to the annual meeting. Dr. Malone planned that, starting in FY 2017, for the 2016 annual meeting, the Society would contract with a professional meeting manager, thereby reducing the draw on the time of the Executive Office to an estimated 10%. So, in the main budget, the annual meeting appears on three lines: Under income, and under expenses, both for the Executive Office alone and net of Executive Office expenses. As of this writing, though, it appears that the Society will not employ such a meeting manager until FY 2018, for the 2017 annual meeting. I recommend that the income and expenses of the annual meeting be viewed both with and without the Executive Office expenses, in order to appreciate its net financial consequences for the Society.

Other Executive Office expenses are largely routine and not necessarily deserving of the attention of the Executive Committee and Finance Committee (except when salaries are reviewed). These can, however, be seen in the office's worksheet within the budget workbook.

At the annual meeting of the Finance Committee in November, 2012, Marc Rothenberg, then a member of the committee, pointed out that it would be helpful to record the value of the annual in-kind contributions from the University of Notre Dame to the functioning of our Executive Office. This would be very important if it ever becomes necessary to renegotiate our arrangement or to move the office. Dr. Malone, with the help of our new auditor, has created a table of these in-kind contributions, and it now appears as a worksheet in the budget workbook.

In 2009, the executive committee decided, for the purpose of calculating the percentage draw on the endowment, 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 2017 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. (With much additional effort, we could present alternative budgets based on different investment scenarios.)

The annual changes in the exchange rate cannot be forecast, and the cost of the *Isis* editorial office for FY 2018 and FY 2019, in dollars, must therefore be regarded as only very rough estimates.

In order better to monitor our finances and control expenses, I have, with the concurrence of the Finance Committee, asked the Executive Office to produce quarterly reconciliations of our actual finances with our budget. I have produced a first draft of our quarterly budgets for FY 2017. These are not simple divisions of the annual budget into quarters, because some cash flows are specific to quarters. For example, most income and expenses associated with the annual meeting occur in the first two quarters, and are not divided evenly between these two. As of this writing, these quarterly budgets are under review by the Executive Office, and after we reach agreement on them, I hope that our first quarterly reconciliation will be made for the first quarter of FY 2017.

10. Reserve Fund

The Reserve Fund holds special-purpose, non-endowment, funds. Historically, these have been primarily 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 monies 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.

11. Endowment Fund

The Endowment Fund consists of a general fund and twelve 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 and Engagement Committee, the Hazen Education Prize ($1000), programs and support for teachers, 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*)

Elizabeth Paris Endowment for Socially Engaged History and Philosophy of Science (to fund a regular public event, and still in creation, as noted above)
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 will later appear in a draw calculation worksheet, and will be confirmed by the auditor in anticipation of Council's November meeting.

12. Advancement and Outreach

In connection with the advancement of the Society's purposes, the Executive Office has arranged to share the services of an outreach coordinator, Dr. Jessica Baron, with the Reilly Center. The Society was contracting for one-quarter of her time; in FY 2017, this has become half of her time. The position appears in the Executive Office's budget on the line labeled "Director of Media and Engagement."

13. Auditor

In 2011, the Executive Office, after securing bids from three firms and in consultation with the treasurer, hired the South Bend accounting firm of Jurgonski & Fredlake, CPAs, which had extensive experience with non-profits. Their last audit was conducted in August 2014, during which the treasurer was not present. In the draft audit report, there were no serious outstanding issues.

In December 2014, Jurgonski & Fredlake merged with another local firm. It therefore seemed to Dr. Malone and me to be an appropriate time to consider the retention of a new auditor, which is simply good practice. It is considered risky to come to rely on a single auditor over a very long span of time, because the auditor and the client can become too cozy and complacent. But there was another motivation: We found that Jurgonski hadn't filed our Form 990 extension on time. (Form 990 is the return filed with the Federal government by non-profit organizations, and is due five and a half months after the end of the fiscal year, making that date, in our case, November 15.)

Rectifying this matter took a lot of Dr. Malone's time in the first half of FY 2016.

In the course of sorting out this last problem, Dr. Malone realized that Jurgonski & Fredlake had never delivered to us the final audit report for FY 2014. All we had received was what Council saw in 2015: the draft audit report. Seeing that had lulled us into thinking that the final audit report couldn't be far behind. But it could be. It then occurred to Dr. Malone to check the previous years. And so it turned out that Jurgonski & Fredlake had not even delivered the final audit reports for FY 2012 and FY 2013. Dr. Malone naturally contacted the successor firm, but

Greg Jurgonski himself said that he could now not complete the audit, because the firm that had conducted the preliminary work no longer existed as such. (Dr. Malone and I find this hard to believe.) Even to get this much response actually took a telephone call from our lawyer, Stephen M. Schaefer, Esq., who quoted the Web site of the successor firm, which assures readers that the transition from Jurgonski & Fredlake to the new firm will be seamless.

Fortunately, it seems that there are no ill consequences for us for failing to have a complete audit for those three years. But it has complicated the work of the audit for the latest fiscal year, FY 2015.

After Dr. Malone made enquiries and sent an RFP to a few more firms, we selected Plante Moran, a regional firm that has been around for about a century. All the responses to our RFP came in at considerably higher costs than what we had been paying Jurgonski & Fredlake. This time, we were given the audit for which we were paying. But we also had to pay Plante Moran an additional fee to test the final balances from the previous year, which ought, normally, to have been considered reliable as a result of the previous audit. The audit took considerably more time than Plante Moran initially estimated. The total cost to us in FY 2016, therefore, came to $28,000, plus $1500 for the tax filing. This is considerably greater than the amount budgeted for the annual audit in FY 2016, $13,500. This reflects the cost of sorting through the mess left from FY 2014, the FY 2015 audit itself, and, more important, reconstructing the gifts to the endowment in order to remove a qualification in past audits. (Note that this was not a full audit for FY 2014; rather, it was just enough work to provide the starting position for the new audit.) But we do have a final auditor's report on FY 2015.

Henceforth, we should expect the annual audit to cost us about $19,000, rather than the $11,000 we had been paying Jurgonski & Fredlake. I should note that, in actuality, we paid only $6500 for the FY 2014 audit, and the additional cost we incurred in FY 2016 was therefore more or less in line with what we would have paid in FY 2015 had Jurgonski & Fredlake completed that audit.

I was in South Bend in September 2015 for a couple of days to meet the new auditors and, with Dr. Malone, to ask and to answer questions. Among the topics we discussed were best practices for financial controls, to keep our funds safe in the event that Dr. Malone or I, or our successors, turn dishonest.

We now have in hand the draft audit for FY 2016. It shows total revenue of $978,427, and total expenses of $1,138,179, for a loss of $159,752. This does not correspond to our operating budget, because revenue here includes in-kind contributions, which, for budgeting purposes, we record as separate from operating income, and it does not include draws on the endowment, which we budget as income. (The audit shows investment income and the net of realized and unrealized gains and losses.) Further, expenses include donated materials and goods, which are also not part of our operating budget.

The draft of the auditor's letter makes two recommendations: First, to evaluate our annual spending policy, of draws on our endowment, in accordance with the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), and second, to continue to evaluate our internal controls and segregation of duties over cash receipts, especially as we move forward with a capital campaign, which might develop new paths for funds to reach us. On the first point, the letter concludes

> A spending policy is a living document; it's important for nonprofits to revisit it periodically and ask, "Is this still appropriate for our current budget and economy?" Today's volatile market environment may challenge the Society's ability to accurately budget annual cash flows available from portfolio performance.

14. Bookkeeper

During my September 2015 visit to the Executive Office, I also had a chance to meet our new bookkeeper, Suzanne Gibbons, from another local CPA firm, Aranowski & Co. Her boss, David Aranowski, met with us at the same time. Dr. Malone and I agreed in August 2015, with the concurrence of the rest of the Executive Committee, that it would be best to free up Greg Macklem's time, as well as Dr. Malone's, by retaining a part-time bookkeeper. She can keep an independent eye on our numbers and, as I noted earlier, has been sending me monthly reports on our income, expenses, and financial asset valuations. As of the summer of 2016, she has been including the value of our endowment in her reports.

15. Action Items

These are the action items from last year:

1. Formally establish basis value of the unrestricted general endowment.
   This has now been done.
2. Enter the basis values of the restricted funds into the Merrill Lynch investment accounting system.
   Now that item 1) has been accomplished, we should be able to do this in FY 2017.
3. Investigate and record the value of the annual in-kind contributions of the University of Notre Dame and others. Record these in the budget.
   This has been done.
4. Establish a policy on receipt of gifts, either monetary or in kind.
   This has been done, and the statement was approved by Council in November 2015.

There are two new action items:

1. Investigate the possibility of moving the management of the endowment to a lower-cost professional manager, and in particular, investigate the possibility of moving to Vanguard.
2. Remove the restriction that annual meeting surpluses be used only for funding the next year's annual meeting and travel grants.

Respectfully submitted,

Adam Jared Apt, CFA
Treasurer

Attachments:
Workbook with the Final FY 2017 Budget, and the Preliminary Budgets for FY 2018 and FY 2019.

Workbook with budget reconciliation for FY 2016