

MINUTES OF THE APRIL 26, 2010, FINANCE COMMITTEE MEETING

The Finance Committee (“the Committee”) of the Smithsonian Board of Regents met on Monday, April 26, 2010, at 2:00 p.m. at the Smithsonian Institution in Washington, D.C. Participating were Committee Chair Roger Sant, member David Rubenstein*, and ex officio member Patricia Stonesifer. Staff in attendance were Secretary G. Wayne Clough; Treasurer Sudeep Anand; Chief of Staff to the Secretary Patricia Bartlett; Smithsonian Enterprises Chief Financial Officer Gregory Bokman; Office of Planning, Management and Budget Director Bruce Dauer; Assistant Inspector General for Audits Daniel Devlin; General Counsel Judith Leonard; Chief Financial Officer Alice Maroni; Under Secretary for Finance and Administration Alison McNally; and Smithsonian Enterprises President Tom Ott. Also in attendance was Budget Analyst Amy Crochiere, who recorded the minutes.

Call to Order and Approval of Minutes

Committee Chair Roger Sant called the meeting to order and greeted the members. The Committee approved the minutes of the January 20, 2010, meeting.

Smithsonian Institution Fiscal Year 2012 Budget Priorities

Mr. Dauer updated the Committee on the fiscal outlook for 2012, which continues to be a concern. The fiscal year 2011 President’s budget established the Institution’s fiscal year 2012 Federal planning budget at \$764 million, 4.3 percent below the fiscal year 2011 request of \$798 million. The Institution had hoped to receive an early decision from the Office of Management and Budget (OMB) on its need for \$205 million in fiscal year 2012 for construction funding for the National Museum of African American History and Culture. However, OMB cancelled its spring review, and this request will be considered during the normal budget review. With regard to the Institution’s Trust funds in fiscal year 2010, the Institution is confident it will achieve its stretch fundraising goal of \$142 million because it has several major gifts in the pipeline. Government grant and contract awards in the first half of fiscal year 2010 have increased by 19 percent over 2009 and are on track to reach the stretch goal of \$130 million. Lastly, the Institution is making progress on several new revenue initiatives including Smithsonian Enterprises’ agreements with QVC, FTD, and Time, Inc.; and efforts to increase overhead recoveries.

Mr. Dauer then presented the fiscal year 2012 budget priorities proposed by the Secretary. In light of the focus on deficit reduction by the Administration and Congress and the prospect of reduced Federal budgets in the near future, the Institution will concentrate its request for Federal budget increases in only a few areas. The Institution’s number one priority is the National Museum of African American History and Culture. Limited increases will also be sought for non-discretionary items including rent, utilities, and the mandated pay raise; collections care; and broadening access through education, digitization, and web access. The Institution will take advantage of the best practices study and the trust team recommendations in planning for likely fiscal year 2012 federal reductions. In addition, the Institution will engage the units in determining how to reduce the budget by 6 percent and 10 percent, respectively.

* *participated by teleconference*

Unit recommendations will be evaluated and incorporated into the Smithsonian's budget submission to OMB, if, as is likely, required to meet OMB's budget guidance. The proposed OMB submission, including any necessary reductions, will be presented to the Finance Committee in August 2010 for approval before submission to OMB. The Committee and staff discussed the possible actions that might be proposed to save the Institution money such as closing museums and exhibitions, reducing museum operating hours, and furloughing staff. The Committee also discussed the outlook for fiscal year 2011, including the possibility of spending changes in fiscal year 2011 to prepare for fiscal year 2012.

The Committee approved the following motion:

VOTED that the Finance Committee recommends that the Board of Regents approves the fiscal year 2012 annual budget priorities proposed by the Secretary.

Update on Discovery Center Refinancing

The Institution issued \$41.3 million of tax-exempt bonds in 1997 to finance the Discovery Center at the National Museum of Natural History. The current outstanding balance is \$32.7 million at an average interest rate of 5.1 percent. In June 2009, the Committee and the Board of Regents approved the refinancing of this debt. Treasurer Sudeep Anand updated the Committee on the status of this refinancing, reporting that the new bonds were priced on April 19, 2010, will close on April 29, 2010, and that the redemption of the old bonds will occur on May 10, 2010. The new bonds are non-callable and were issued at premium, with a weighted average life of 10.5 years. The weighted average interest rate on the new bonds is 3.8 percent versus 5.1 percent for the existing bonds. This will save the Institution more than \$250 thousand annually in debt service, and \$4.4 million over the life of the bonds. Both Standard and Poor's and Moody's affirmed the Institution's AAA and Aaa credit ratings, respectively.

Smithsonian Enterprises – Update on Fiscal Year 2010

Mr. Ott reviewed Smithsonian Enterprises' (SE) fiscal year 2010 performance. SE is on track to achieve its stretch net gain goal of \$26 million in fiscal year 2010, with a \$700 thousand variance over budget through March due to expense improvements from past restructuring efforts. The primary risks to achieving the stretch goal are magazine advertising, which is projected to stabilize in the second half of the fiscal year, and visitation, which must be comparable to 2009 visitation for SE retail to meet its projections. Mr. Ott discussed the key initiatives that were implemented in the first half of fiscal year 2010 and noted that SE received an unqualified KPMG audit opinion for fiscal year 2009.

In terms of capital investment, SE's budget estimate is \$5.1 million, down from the original estimate of \$6.4 million. This is a net result of the removal of \$1.75 million for the Carmichael Theater conversion at the National Museum of American History and the addition of \$700 thousand of unbudgeted, deferred projects. The most significant investments in the second half of the fiscal year are the refurbishment of the current retail location or the addition of a second location at Dulles Airport and the purchase of an improved point of sale ticketing

system for SE's theaters. Lastly, SE's Chief Financial Officer presented SE's balance sheet as requested by the Committee at a previous meeting. Committee discussion centered on the Smithsonian Networks contract, "greening" SE's product lines, establishing partnerships with high-traffic web sites similar to the Institution's relationship with Yahoo, and gaining access to mainstream movies at SE theater locations.

Smithsonian Institution Fiscal Year 2010 Financial Report

Mr. Sant reviewed the Endowment performance through March 31, 2010. The Endowment value at the end of March was \$938.5 million. Its trailing one-year-return of 27.5 percent was below the policy benchmark of 35.5 percent; while the annualized five-year trailing return of 5.2 percent beat the policy benchmark of 3.9 percent. Mr. Sant reported that the Institution is getting much closer to implementing its policy targets for the various asset classes. The Committee will consider the Endowment payout for fiscal year 2011 at its next meeting on June 9, 2010.

Ms. Maroni then presented the fiscal year 2010 financial report. This report summarizes the Institution's financial performance against budget from October 1, 2009 to December 31, 2009. It highlights the five key funding sources that have the most impact on the Institution's operations and financial stability and tracks performance against quarterly goals. With respect to Federal appropriations, the Institution received \$2 million more than the budget request for collections care based on concern about the National Museum of American History's military collections. The amount of funds raised through the first quarter at \$18 million is lagging compared to the plan, but there are several major gifts in the pipeline that should propel the Institution toward its stretch goal of \$142 million. Government grants and contracts are on pace with the stretch goal (\$130 million), as are Smithsonian Enterprises net gains (\$26 million). With respect to the Endowment, its value rebounded to \$911 million at the end of December 2009, to \$133 million over budget. The budget for the Endowment reflects the assumption of no growth based on the recommendation of the Institution's Chief Investment Officer. The report also tracks expenses against quarterly goals. For the first quarter, the variance from the budget for expenses was only 0.6 percent. The Committee then discussed the format of the report. The Institution continues to work to refine the report to provide a shorter, more accessible format to replace the narrative report used in the past. The Committee agreed that the report is moving in the right direction, but suggested additional ways to improve the report including a more detailed breakdown of the quarterly expenses and an added column for a full-year budget forecast. The Committee also discussed receiving the quarterly reports between meetings so that they receive the information in a more timely manner.

Status of Best Practices Study

Secretary Clough provided the Committee with an update on the Best Practices Study. This study is evaluating whether the Institution is organized as efficiently and effectively as possible to execute the Institution's strategic plan. The Institution's consultant for this study, McKinsey & Company, has completed the first phase of the study and has recommended improvements to several of the Institution's processes as well as new organizational structures. The Secretary

will form a team made up of a pan-Institutional group of staff and a small subset of the McKinsey team to implement these recommendations as part of phase two of this study. Mr. Sant reminded the Committee that four outside consulting experts, serving as an advisory board to the Committee, continue to advise and guide the Institution through this process.

Wrap Up

The Chair thanked the members of the Committee and staff for their active participation and adjourned the meeting to conduct an executive session at 3:55 p.m.