

## MINUTES OF THE AUGUST 23, 2010, FINANCE COMMITTEE MEETING

The Finance Committee (“the Committee”) of the Smithsonian Board of Regents met on Monday, August 23, 2010, at 3:00 p.m. at the Smithsonian Institution in Washington, D.C. Participating were Committee Chair Roger Sant\*; members David Rubenstein\* and David Silfen\*; ex officio member Patricia Stonesifer\*; and Regents Phil Frost\*, Robert Kogod\*, Congresswoman Matsui\*, and Alan Spoon. 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; Chief Investment Officer Amy Chen; Director of External Affairs Virginia Clark; Office of Planning, Management and Budget Director Bruce Dauer; Assistant Inspector General for Audits Daniel Devlin; Chief of Staff to the Regents John K. Lapiana; General Counsel Judith Leonard; Chief Financial Officer Alice Maroni; Under Secretary for Finance and Administration Alison McNally; Smithsonian Enterprises President Tom Ott\*; and Inspector General A. Sprightley Ryan. Also in attendance was Budget Analyst Ed Patrick, 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 June 9, 2010, meeting.

### **Fiscal Year 2010 Third Quarter Financial Report and Year-End Forecast**

Ms. Maroni reviewed the fiscal year 2010 third quarter financial report and year-end forecast. The report summarizes the Institution’s financial performance against budget from October 1, 2009, to June 30, 2010, as well as provides a fiscal year-end forecast. 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. All five key sources are forecast to meet or exceed either their stretch goals or their budgets. As a result, the Institution now projects a \$147 million increase in net assets during fiscal year 2010, \$56 million more than budgeted. This increase primarily reflects the growth of the Endowment’s market value and achievement of the Institution’s stretch fund-raising goals. The Central Trust budget is expected to end the year in balance and, as in fiscal year 2009, be able to cover a portion of Central’s required share of the debt service for both Udvar-Hazy and the Discovery Center in fiscal year 2011.

### **Fiscal Year 2011 Federal and Trust Combined Budget**

Ms. Maroni then presented the fiscal year 2011 combined budget. The five key revenue sources for fiscal year 2011 that have the most significant impact on the Institution’s operations and financial stability are Federal appropriations, fund raising, government grants and contracts, new revenue, and the Endowment’s payout. Taken together, these revenue sources represent an increase of \$82.5 million, or 8 percent, over the fiscal year 2010 budget.

With respect to Federal revenue, the budget is based on the fiscal year 2011 budget request submitted to Congress in February 2010. Totaling \$797.6 million, it contains a \$36.2 million, or 5 percent, increase over the fiscal year 2010 budget and consists of \$660.8 million for salaries

\* *participated by teleconference*

and expenses and \$136.8 million for facilities capital. A Continuing Resolution would delay Federal funding for the hiring and spending increases included in the fiscal year 2011 budget.

The other component of the fiscal year 2011 budget is Trust revenues, estimated to increase \$46.3 million from fiscal year 2010. The increased Trust revenues in the fiscal year 2011 budget include \$28.2 million in Smithsonian Enterprises (SE) net gain ; \$175 million in fund-raising results (a 23 percent increase over fiscal year 2010 that reflects national campaign contributions); \$122 million in government grants and contracts (an 8 percent increase over fiscal year 2010); and \$50.9 million from the Endowment's payout, based on the per share payout rate of \$39.30 approved by the Board of Regents at its June 2010 meeting.

Expenses are estimated to be \$1.023 billion in fiscal year 2011, an increase of \$42 million or 4 percent more than the fiscal year 2010. Over half of the increase in expenses is attributed to increased Federal funding and the expectation that the Institution will begin using the Legacy Fund. The increase in Trust expenses is associated with furthering the strategic plan's priorities and will be funded through higher levels of grant and contract activities and increased donor funding.

Ms. Maroni reported that the Central Trust budget is in balance. It reflects increased revenue from Smithsonian Enterprises, and donations to Friends of the Smithsonian and Corporate Memberships. It also benefits from a new indirect cost rate structure, a recommendation from the Trust Budget team that significantly increased recovery of indirect costs from grants and contracts. Because of the strength of the Central Trust budget, the Institution will eliminate the longstanding Trust hiring freeze and provide a small increase to enable the Institution to comply with payment card industry data security standards and continue accepting payments from individual VISA, MasterCard, and other credit payment cards. Lastly, full time Central Trust positions are beginning to be moved to the Federal budget. This will support more scalable programs and provide greater flexibility in the Central Trust's ability to respond to revenue declines.

Ms. Maroni concluded the presentation by noting that the year-end Endowment market value is budgeted for \$941 million. This reflects the policy objective of 5.5 percent growth and contributed to the Institution's fiscal year 2011 budget bottom-line change in net assets of \$183 million.

The Committee approved the following two motions:

**VOTED** that the Finance Committee recommends that the Board of Regents approves the budget of appropriated funds for fiscal year 2011 when signed into law by the President and authorizes expenditures by the Secretary in accordance therewith. Any material changes in program plans incorporated into this budget shall be made only with the approval of the Board of Regents or its Executive Committee.

**VOTED** that the Finance Committee recommends that the Board of Regents approves the institutional budget for Trust funds for fiscal year 2011 reflected in this report and

authorizes expenditures by the Secretary in accordance therewith. Any material changes in program plans incorporated into this budget shall be made only with the approval of the Board of Regents or its Executive Committee.

### **Fiscal Year 2012 Federal Budget Submission to the Office of Management and Budget**

Fiscal year 2012 budget guidance from the Office of Management and Budget (OMB) directed all Federal agencies to submit significantly lower budgets than fiscal year 2011. Secretary Clough reminded the Committee that, although OMB provided the same budget guidance for fiscal year 2011 budget submissions, it ultimately supported an increase in the Institution's fiscal year 2011 budget request. Because of the nation's deficit, however, the Institution cannot assume the same response from OMB this year.

The Secretary created a Directors Advisory Group to provide input and feedback on the fiscal year 2012 Federal budget submission. Meetings with the group helped establish ground rules that guided the development of the fiscal year 2012 Federal budget. The ground rules included preserving fiscal year 2011 increases that support the strategic plan; sustaining current funding levels for education; maintaining museum hours because Trust revenue losses would offset any Federal savings; and rejecting furloughs. The Secretary said that the Institution should expect some budget cuts, despite its strong relationship with OMB.

Mr. Dauer then went into more detail on the proposed fiscal year 2012 Federal budget request. The President froze the non-security, non-mandatory portion of the fiscal year 2012 Federal budget at fiscal year 2010 levels. OMB's guidance set the Smithsonian's budget 9 percent below its fiscal year 2011 budget level, which would require 11 percent in reductions to pay for unavoidable fixed costs. OMB also required Federal agencies to submit lists of low-priority programs that total at least 5 percent of their fiscal year 2010 discretionary appropriations, which for the Smithsonian would total \$38 million. This list only includes items reduced in the OMB guidance budget. However, similar to fiscal year 2011, OMB also agreed to accept a "within reason" requirements budget. The Smithsonian will therefore present two budgets to OMB: requirements and guidance. In addition, and with encouragement from OMB, the Institution will separately request the \$205 million needed to complete Federal funding for the construction of the National Museum of African American History and Culture.

The fiscal year 2012 requirements budget totals \$821 million, which includes \$684 million for salaries and expenses (a \$23 million increase from fiscal year 2011) and \$137 million for the facilities capital budget (which is flat with fiscal year 2010). The increases are focused on the budget priorities approved by the Regents in June 2010. Using the fiscal year 2011 requirements budget as a model, which included a \$37 million increase from fiscal year 2010, management believes this small increase for fiscal year 2012 will comply with OMB's request to make it "within reason."

The guidance budget requires a reduction of \$72 million, or 9 percent, from the fiscal year 2011 Federal request, which results in a \$726 million budget for fiscal year 2012. However,

unavoidable increases for federally mandated pay raises, rent, and utilities would result in an actual reduction of \$88 million.

The \$726 million guidance budget is made up of \$626 million for salaries and expenses (a \$35 million decrease from fiscal year 2011) and \$100 million for facilities capital (a \$37 million decrease from fiscal year 2011). After taking the advice of the Directors Advisory Group and considering relative contributions to the strategic plan, management proposed reductions as follows: research (–\$7.1 million), exhibits/outreach (–\$7.2 million), collections (–\$4.4 million), IT services consolidation (–\$3.0 million), management operations (–\$9.6 million), facilities operations and maintenance (–\$19.7 million), and facilities capital (–\$37 million). The only increases were for fixed costs (\$16 million).

The Committee encouraged future consolidations and efficiencies to reduce costs. They also discussed the potential need to close a museum or center in the future. In addition, the Committee recommended that the IT services consolidation be included in the requirements budget to reduce the increase request and to demonstrate good faith.

The Committee approved the following motion:

**VOTED** that the Finance Committee recommends that the Executive Committee, on behalf of the Board of Regents, approves for presentation to the Office of Management and Budget the proposed Smithsonian fiscal year 2012 budget requests — Requirements and Guidance — subject to the following amendment: that the Requirements request also reflect anticipated savings from the Institution-wide consolidation of information technology services. Any material changes in program plans incorporated into this budget shall be made only with the approval of the Board or the Executive Committee.

### **Smithsonian Enterprises: Fiscal Year 2010 Forecast, Fiscal Year 2011 Budget, and Long-Term Plan**

Mr. Ott provided an update on Smithsonian Enterprises' (SE) fiscal year 2010 forecast, fiscal year 2011 budget, and long-term plan. SE expects to end fiscal year 2010 with a \$26 million net gain, which is a \$1 million increase over its earlier fiscal year 2010 budget. This is driven primarily by a strong performance by SE stores and food and beverage operations. SE plans to increase its fiscal year 2011 net gain by \$2.2 million, totaling \$28.2 million. This increase is driven by an increase in the Smithsonian Channel licensing fee, cost savings and revenue enhancements due to *Smithsonian* magazine's new relationship with Time Inc., a new off-Mall store location, and a re-scoped multi-use theater venue in the National Museum of Natural History, as well as an improved movie release schedule.

Next, Mr. Ott reviewed SE's long-term plan (LTP) for fiscal years 2010 to 2014. The plan was approved by the Secretary and Ms. McNally in January 2010. The plan shows net gains growing from \$26 million in fiscal year 2010 to nearly \$40 million in fiscal year 2014. Though all SE units showed significant growth in the LTP, the main driver of this \$14 million increase in net gain is

the retail division, which expects to increase its net by \$9 million over this time period. The division plans to do this by leveraging higher margin products, creating an affiliate buying office, consolidating distribution centers, growing off-Mall hub stores, and finding efficiencies through store consolidations at the National Museum of the American Indian, and potentially at the National Air and Space Museum. For their restaurants, SE plans to incorporate industry “best practices” for sustainability, leverage the American Indian Museum’s Mitsitam brand into a cookbook (and, potentially, packaged foods), and perhaps open an additional restaurant location. The remaining driver in the retail division is the theaters and simulators division, where SE will integrate more 3-D digital technology into the theaters, introduce simulators at the Natural History Museum, and more effectively manage the operation of the simulator business. The remaining increase to net gain will be split about equally between the media and consumer products division, which will involve optimizing the Time Inc. relationship, evolving the Smithsonian Channel agreement, growing the travel business, and developing more opportunities with licensing agreements, such as those with QVC, credit card, and genealogy products.

Mr. Bokman gave a brief balance sheet overview. SE does not maintain its own cash accounts, and all cash activity is swept to the Institution’s bank accounts. SE’s balance sheet is largely traditional working capital and deferred income, primarily from magazine subscriptions not yet served. Inventory levels are largely seasonal: catalog inventory is higher during the fall season and museum retail store inventory is higher in the spring and summer, although the retail division’s ongoing rationalization of both groups’ inventory was a partial driver in the September 2009 to June 2010 decline of \$2 million. Prepaid expenses were lower by \$3 million due to lower paper catalog distribution and lower magazine promotion activity. Overall fixed assets declined due to lower reinvestment levels into property and equipment over recent years.

At the conclusion of the SE’s presentation, the Committee affirmed SE’s long-term plan.

### **Smithsonian-George Mason University Conservation Education Program Funding**

Mr. Anand notified the Committee that the National Zoological Park (NZN) must raise the remaining \$5.05 million of the \$11.65 million fiscal year 2012 target to fully fund the Smithsonian’s share of the George Mason University Conservation Education Program. If NZN isn’t able to raise the remaining amount in time, or if the Zoo has no other source of income to repay the Institution’s funding advance for this program, the Finance Committee will be asked to consider a motion to redeem funds as necessary from the NZN’s unrestricted endowment.

### **Wrap Up**

The Chair thanked the members of the Committee and staff for their active participation and adjourned the meeting at 4:00 p.m. The Committee then conducted an executive session.