MINUTES OF THE AUGUST 24, 2009, FINANCE COMMITTEE MEETING

The Finance Committee ("the Committee") of the Smithsonian Board of Regents met on Monday, August 24, 2009, at 3:00 p.m. at the Smithsonian Institution in Washington, D.C. Participating were Committee Chair Roger Sant*, members Robert Kogod*, David Rubenstein*, and David Silfen*; ex officio member Patricia Stonesifer*; and Regents John McCarter* and Alan Spoon*. Assistant to Representative Matsui Julie Eddy* and Assistant to Representative Bercerra Melody Gonzales* also participated. Staff in attendance were Secretary Wayne Clough; Acting Under Secretary for Science Charles Alcock*; Treasurer Sudeep Anand; Office of Human Resources Associate Director Gregory Bettwy; Smithsonian Enterprises Chief Financial Officer Gregory Bokman; Director of External Affairs Virginia Clark; Office of Planning, Management and Budget Director Bruce Dauer; Office of Human Resources Director James Douglas; Under Secretary for History, Art, and Culture Richard Kurin; Chief of Staff to the Board of Regents John Lapiana; 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 June 10, 2009, meeting.

Update from the Secretary

Secretary Wayne Clough expressed his appreciation to Smithsonian staff for their hard work in preparing the Institution's budgets. He then updated the Committee on the progress of the Trust study teams. He said that the report of the Zero Based Team, which recommended that the spending philosophy governing Central Trust funds should focus on one-time and seed money expenditures only, would be presented to the Executive Committee in September 2009. He said that the report of the Revenue Generation Team would be reviewed with the Board of Regents after the team had completed some additional research and evaluation. The Secretary also explained that proposals were currently being evaluated to hire a contractor to complete a best practices study designed to ensure the Institution was organized effectively and efficiently. Finally, he noted a few initiatives that the Institution would pursue to cut costs, including IT consolidation, outsourcing units, and rightsizing organizations.

Smithsonian Enterprises Fiscal Year 2009 Performance Update and Presentation of the Fiscal Year 2010 Budget

President of Smithsonian Enterprises (SE) Tom Ott reviewed SE's fiscal year 2009 performance and presented the fiscal year 2010 budget and capital plan. For fiscal year 2009, SE's original budget projections included total revenue of $174.9 million and net gain of $27.2 million.

Due to the poor economic climate, SE was faced with a budget gap of $21.2 million in

** participated by teleconference*

revenue and launched an $11.5 million cost-cutting and revenue-boosting program which narrowed the net gain budget gap to $1.2 to $2.2 million. Mr. Ott reported that during the summer, SE's retail businesses had experienced sales higher than fiscal year 2008 levels, partially driven by efforts to maximize events and product sales associated with the *Night at the Museum: Battle of the Smithsonian* movie, as well as through promotions tied to other special events, such as the anniversary of the first lunar landing. He said that SE believed it would achieve $25.5 million in net gain and perhaps $26 million by the close of fiscal year 2009.

Mr. Ott said that SE projected $25 million in net gain after taxes for fiscal year 2010, which would be flat with the earlier fiscal year 2009 forecast. SE's fiscal year 2010 budget assumed a similar economic environment, but without the one-time events that contributed to SE's fiscal year 2009 performance, including the Presidential Inauguration, the reopening of the National Museum of American History, the *Night at the Museum: Battle of the Smithsonian* movie, and the anniversary of the first lunar landing. The budget also included $500,000 held in corporate investment initiatives, which would be used for business building activities or as a buffer if economic conditions deteriorated further. He said that the preliminary plan for capital investment in fiscal year 2010 was $6.374 million and that the largest project was the conversion of the Carmichael Auditorium at the American History Museum into a digital theater. Most of the remaining projects were deferred maintenance and system upgrade projects in Retail. Regent Sant asked that SE's balance sheet be included in future presentations so that capital expenses are visible. He also expressed his thanks, as did other members of the Committee, for SE's efforts to maintain net gain.

Fiscal Year 2009 Year-End Budget Forecast

Chief Financial Officer (CFO) Maroni reviewed the fiscal year 2009 year-end financial report. She noted that fiscal year 2009 had been a difficult year financially as the economic crisis that began in fiscal year 2008 continued to take its toll on the Institution throughout fiscal year 2009. Overall, income was forecast to fall below budget by $8 million, reflecting declines in charitable giving, interest income, and SE net gain. These revenue declines were offset by an increase in Federal revenues, including funding from the American Recovery and Reinvestment Act of 2009, the Presidential Inaugural Committee, and government grants and contracts. Expenses were forecast to exceed budget by $5 million due largely to the increase in Federal spending for operations, offset by management actions to reduce unrestricted Trust spending. The Endowment forecast did not attempt to forecast the Endowment's performance for the last quarter of the fiscal year. Rather it assumed the June 2009 month-end market value, less payouts, would be the ending value. The Institution's diversified investment portfolio had a value of $818 million through June 2009 and beat its policy benchmark returns. The Institution's net assets were forecast to decrease at year-end by $31 million due to the poor performance of the economy.

With respect to the Federal budget, the Institution ended the year in good shape despite the uncertainty it experienced during the first half of the fiscal year while operating under a Continuing Resolution. In March 2009, Congress enacted and the President signed into law an omnibus appropriations bill that resulted in a 7 percent increase in Federal funding for the Smithsonian over the prior year and covered most of the Institution's mandatory expense increases. Most importantly, the appropriation restored base funding for existing public programs, education, and research that had been cut by the Office of Management and Budget (OMB). The Institution also received $25 million from the American Recovery and Reinvestment Act of 2009 for facilities repair and revitalization.

With respect to the Central Trust budget, all major sources of income declined. As a result, the Institution confronted a serious gap between Central Trust income and expenses. Management addressed the expected budget gap by reducing unrestricted Trust spending by $7 million. Ms. Maroni said that management recognized that the structural imbalance in the Central Trust budget was unsustainable and was fully engaged in the assessment of the recommendations made in June 2009 by the Trust study teams commissioned by the Secretary.

Presentation of the Fiscal Year 2010 Budget

Ms. Maroni then presented the fiscal year 2010 budget. She reported that the budget for fiscal year 2010 revenues assumed Federal revenues based on the budget request submitted to Congress in February 2009, and Trust revenues based on SE net gain of $25 million, contributions of $130 million, and an Endowment payout frozen at the prior year rate. The budget for fiscal year 2010 also assumed increased spending for Federal activities consistent with the appropriation increase contained in the fiscal year 2010 President's budget and constrained spending for Trust activities due to management actions designed to balance expenses with revenue. It also assumed $3 million of expenses for the National Campaign. She noted that several assumptions would require subsequent action by other Regent Committees.

She said that Federal income was projected to increase by $58 million or 8 percent, reflecting the increase in appropriations and the higher spending from the stimulus package. Restricted Trust income was budgeted to increase 12 percent due to NASA's support of the Smithsonian Astrophysical Observatory and the Institution's fund-raising goal of $130 million. Unrestricted Central Trust income was not projected to increase. Ms. Maroni said that overall expenses were budgeted to increase by $32 million or 3 percent, an increase that largely reflected year-over-year increases in Federal spending for Salaries and Expenses driven by the mandatory pay raise and increases for rent and utilities. Restricted Trust spending was projected to decline, reflecting the normal ebb and flow of spending on exhibitions and programs. The decline in unrestricted Trust spending reflected management actions to bring spending in line with revenue.

Ms. Maroni reported that management achieved a balanced Central Trust budget through four major initiatives in fiscal year 2010. First, management proposed a special Endowment payout to fund the expenses of the National Campaign, combined with what remained from the funds previously made available to the Campaign. She noted that this payout was contingent upon the Advancement Committee's approval of the program being planned by the Office of External Affairs and the specific items budgeted. Second, management recommended a major restructuring of The Smithsonian Associates (TSA), which sponsors a wealth of seminars, tours, and lectures for the local metropolitan

Washington audience who pay a fee to participate. Ms. Maroni explained that the budget reflected a change in the treatment of TSA because it operated at a loss to the Institution, and said that it would be treated like other businesses and operate to at least break even over time. She added that, if this was not possible, TSA would be closed down. At Regent Stonesifer's suggestion, the Committee agreed that the proposed restructuring would be contingent upon approval by the Strategic Planning and Programs Committee.

Regarding the third initiative, Ms. Maroni reported that management issued revenue targets to the Trust Finance Implementation teams, as the budget assumed $650,000 in new revenue initiatives that would get started in fiscal year 2010. In the fourth initiative, management proposed three personnel initiatives that would be contingent upon approval by the Compensation and Human Resources Committee: a pay freeze for all Trust-funded staff, a buyout program offered to both Federal and Trust employees, and a Trust hiring freeze. The Secretary clarified that SE employees would not be subject to the pay freeze in fiscal year 2010 and that the pay freeze for non-senior employees would be reconsidered if fiscal year 2010 income improved. He also explained that any new hires made possible by the buyout would be made within the context of the Strategic Plan. [In action following the Committee meeting, the Committee was informed that there had been three positive changes in the Central Trust budget that, when taken together, restored enough flexibility in fiscal year 2010 to fund modest pay increases for non-senior and senior level staff. A final decision to offer modest pay increases will be made in December 2009, depending on the Institution's financial position.]

The Committee unanimously approved the following resolutions for consideration by the Board of Regents:

> **VOTED** that the Finance Committee recommends that the Board of Regents approves the budget of appropriated funds for fiscal year 2010 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.
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> **VOTED** that the Finance Committee recommends that the Board of Regents approves the institutional budget for Trust funds for fiscal year 2010 reflected in this report and authorizes expenditures by the Secretary in accordance therewith, contingent upon approval of the proposed personnel initiatives by the Compensation and Human Resources Committee, the restructuring of TSA by the Strategic Planning and Programs Committee, and the proposed National Campaign expenses by the Advancement Committee. 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.
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> **VOTED** that the Finance Committee recommends that the Board of Regents approves a special payout from the Institution's Endowment not to exceed $2.5 million to fund the fiscal year 2010 expenses of the National Campaign and

other related development funding requirements, contingent upon approval of the proposed National Campaign expenses by the Advancement Committee.

Fiscal Year 2011 Federal Budget Submission to the Office of Management and Budget

Director of the Office of Planning, Management and Budget Bruce Dauer presented the proposed fiscal year 2011 budgets that would be submitted to OMB on September 14, 2009. It was noted that this was a highly unusual year because the Institution would submit three different budgets. Mr. Dauer explained that OMB requested that the Institution submit two budgets: a budget frozen at the fiscal year 2010 request level and a budget further reduced from that level by 5 percent. He said that the difficulty with these budgets was that the Institution must pay mandatory cost increases for the legislated pay raise, as well as rent and utilities escalations, forcing it to make cuts in other areas. The Institution therefore negotiated with OMB to submit a requirements budget that included increases for necessary expenses and programmatic initiatives, as well as many aspects of the strategic plan initiatives.

The freeze budget would require several cuts to the Institution's education programs, including closing the Insect Zoo and Discovery Room at the Natural History Museum, eliminating programs for students at the American Indian Museum in New York City, and discontinuing the operation of research vessels at the Smithsonian Tropical Research Institute. Management, which spent the last several years working to increase maintenance funding, tried to avoid cuts to facilities maintenance. However, in order to keep more painful cuts out of the freeze budget, it was determined that maintenance would have to be cut by $10 million. At the 5 percent reduction level, several museum education departments would be eliminated, a Natural History science department would be eliminated, and the Bird House and Kid's Farm at the National Zoo would be closed, to name a few of the most difficult reductions.

Mr. Dauer explained that, at all levels, the Facilities Capital budget assumed that $24 million of Legacy Funds would be available for the renovation of the Arts and Industries Building. This would require that the Institution raise $24 million in matching private funds. The budget also assumed that construction funding for the National Museum of African American History and Culture would receive special consideration from OMB and would not be subject to the freeze and 5 percent budgets. Committee members requested that these assumptions be footnoted in future Facilities Capital presentations.

The Committee unanimously approved the following resolution for consideration by the Board of Regents:

> **VOTED** that the Finance Committee recommends that the Board of Regents approves the Smithsonian Institution, three level — Requirements, Freeze, and 5% Below — budget request for appropriated funds for fiscal year 2011 for presentation to the Office of Management and Budget. 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.

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 4:50 p.m.