

VP Finance 2003 (Winter) Report **Sloan School, Cambridge MA**
Submitted by David Andersen

(A Personal Note: I regret that I cannot be at this meeting in person due to my sabbatical leave to Scotland. I have created a somewhat longer report than usual, in an attempt to address possible questions.)

Summary: During 2002, the System Dynamics Society posted a net operating loss of \$85,924. We ended the year with total assets of \$229,982. This is a serious loss, but not, in my opinion, indicative of the overall financial health of the Society, rather of a number of factors (some easy to correct, some not) that we need to manage. In the short run, an overall downturn in the economy led to poorer than expected performance of our investments and the Palermo conference posted an unusual loss (presumably, these factors will rectify themselves). In the longer run, the Society, in my opinion, has been operating with a structural deficit for the past five or more years because our stable sources of income do not match our fixed labor expenses. This will be harder to rectify. In addition, functions that were formerly handled by volunteers are now being handed over to our professional staff (this trend is most pronounced in our conference activities, but occurs in all functions of the Society). I recommend that the Administrative Committee closely monitor these trends while drawing up the budget for 2004. In addition, I recommend that the Policy Council reinvigorate its efforts to explore how to deal with the long-term structural imbalance in its budget.

Description of What I See in the Financial Reports

I have included the same set of financial reports that the Policy Council is used to seeing at its winter meeting. I have added a five-year profit and loss comparison (1998-2002) to add some over time perspective to my report. I begin my comments describing the financial status of the Society as reflected in each report:

Five Year Profit and Loss Comparison (1998-2002). The major feature that I see when looking at this five-year comparison is the high degree of variability in annual performance. Last year, the Society posted a five year “best” performance with a net gain of \$74,000. This year, we posted our worst loss of \$86,000. On average, the Society has posted a modest mean gain of \$4,700 per year. I should note that over the same period, the budgets passed by the policy council have predicted annual losses of around \$20,200. In other words over the past five years, the home office operations has out performed Policy Council expectations by about \$15,400 each year (including this year’s losses).

Profit and Loss Previous Year Comparison (2001 vs. 2002). When comparing 2001 to 2002, several noteworthy features of the statement drew my attention. Overall conference income grew by over \$20,000 during that period (indicating that the conference had strong attendance), but expenses grew by more than \$75,000. The reported “labor” component of the expenditures for the whole also grew by more than \$75,000. Over \$71,400 of this growth was planned as reflected in the “Contract with the University at Albany” and about \$5,000 of the growth was in the form of “Professional Fees” representing contracted services to support the home office. On the income side, product and publication sales plus sponsorship and donations declined by more than \$35,000 due to an overall softening of economic conditions. Finally, investment income dropped by almost \$12,000 because of the decline in the stock market.

Budget Comparison, Current Year (2002). The budget comparison table may be a better indicator of why we experienced a deficit in 2002 because it compares our finances against our best guesses about what would happen during the fiscal year. The “big news” in the budget analysis is that conference expenses were about \$50,000 over budgeted (I should note that this line item does not include additional over runs in conference labor that would be contained within the “Contract with

Univ. at Albany” line). In addition, the “Professional Fees” line was about \$16,000 above budget, reflecting additional labor costs at the home office.

Profit and Loss by Cost Centers (2002) The pattern of profit and loss by cost centers follows a usual pattern with one major exception—this year the current year’s conference posted a loss of about \$38,000. Otherwise, the pattern of Core Operations, Publications, and Web activities being subsidized by Sales follows the usual pattern.

Balance Sheet Previous Year Comparison (Dec. 31 2002 vs. 2001). We operate on a cash basis and this year, there were not many unusual “adjustments” to the basic cash position. Hence the balance sheet clearly shows the approximately \$86,000 loss from net income as deducted from past year’s retained earning.

My Analysis of What Happened (*with some Recommendations*).

1. **The Society’s budget has a structural imbalance.** I have said this repeatedly in the past. Members’ dues contribute only about \$10 per member to our staffing and operations and with a membership of fewer than 1,000, we do not generate enough stable income to sustain a professional home office. We rely on home office entrepreneurial activity to keep the Society afloat.
2. **A continuing slide from volunteer to professional activities.** All aspects of the Society’s operations are being defined as part of the workload of our professional staff. While the focus this year is probably on conference related activities, the same trend is happening in all areas. In addition, the home office has been picking up a number of functions previously performed by our partner, Wiley & Sons, such as the newsletter, the directory, and membership renewals.
3. **The Palermo conference went considerably over budget.** This cost over run occurred both in terms of labor and non-labor expenses. I view this as an anomaly that will probably not recur. We need to pay attention to conference budgeting and cost control, but not over react.
4. **The economy took a turn for the worse.** Our investments lost income this year and sponsorship fell off. Of course, it is very difficult to predict what the economy will do in the coming years.

Recommendation #1: Continue to Look Into the Structural Deficit. Last February, we appointed a committee to start this work. We need to explore options such as larger scale sponsorship or some sort of Society endowment for the longer run.

Recommendation #2: Restructure the Budget to Contain Home Office Labor Costs. The Home Office needs clearer guidelines concerning what activities *not* to engage in (i.e., what should remain volunteer) so that we can work to contain overall labor costs.

Recommendation #3: Examine Financial Control Over Conferences. If the conferences can continue to turn a profit, we will probably be OK.

Recommendation #4: Grow the Field. Our long-term strategy has been to use the activities of the Society to grow the field. We need to implement all of our actions with this growth strategy in mind.

Attachments:

1. Profit & Loss –5 Years: 1998-2002 (unaudited)
2. Profit & Loss Previous Year Comparison: 2001-2002 (unaudited)
3. Profit & Loss by Cost Centers for 2002 (unaudited)
4. Budget Comparison, Current Year Only: 2002 (unaudited)
5. Balance Sheet Previous Year Comparison: As of December 31, 2002 (unaudited)