

To: Policy Council of the System Dynamics Society

From: David Andersen, VP Finance  
Eliot Rich, Associate VP Finance

Subject: VP Finance Narrative Report—Part II  
OR  
“How We Plan to Pay for the Transition from UAlbany to Cap Hill”

Date: 10 July 2017

***Exciting Summary:** Continue to explore this exciting sequel to the VP Finance’s Part I thrilling overview of Society expenses and income in 2016. Learn the hitherto underappreciated gems of how the Society funds a dynamic transition to Cap Hill Management Services. Amaze your friends with your deepened knowledge of asset designations and how funds get transferred into the current account. Be awed by the total cost of transition to new Home Office operations. Explore the broad differences between optimistic and pessimistic estimates of transition expenses. Ponder why pessimistic estimates are really best for budgeting purposes. Experience relief as you understand how already designated “rainy day funds” can ease our transition. Be a solid and informed member of those who care about the future of the System Dynamics Society.*

This is the second of three parts to the VP Finance Report. The first part describes what happened in 2016. This second report, focusing on budgets for 2018 and 2019, has two parts: (A) a narrative description of how we plan to budget for the transition from UAlbany to our new home, and (B) a discussion of how designated assets will work to get us through this transition and into the future. The third part describes the recent creation of a new Legacy Fund.

## **Part A: Narrative Discussion of How We Plan to Finance the Transition**

In late 2015, Roberta Spencer sent a letter to the Society’s leadership indicating that she intended to step down from full time duties as Executive Director on or about September 1, 2018. Her letter further indicated that her preference would be to continue working on special projects with the Society, especially projects involving resource development to improve the field as a whole. Her action initiated the creation of a Transition Planning Task force who tackled the question of what would be the future of the Society’s Home Office operations. That task force conducted a broad investigation of options and early in 2017 wrote a detailed report recommending that the Society move its Home Office operations away from UAlbany to an Association Management Firm, Capitol Hill Management Services (Cap Hill) located in Albany, NY. At its March, 2017 meeting, the Society’s Policy Council approved this recommendation and also approved the creation of an advance authorization to spend up to \$100,000 in the near future to initiate this transition.

Attachment 7 to this document (Attachments 1 to 6 present details of the Society’s financial performance in 2016 and were discussed in Part I of this financial report) presents a two-year Society budget reaching out to the end of 2019 that describes how the Society intends to implement this transition. This attachment shows that the Society has already started to incur

transitions costs in the current year and hence will post a budgeted deficit for 2017 of **\$-40,078** that will grow to a planned deficit (pessimistic scenario) of **\$-141,807** in 2018. In 2019, the Society is budgeted to return to a more normal fiscal health and is planned to show an overall Net Income of \$+54,185. As discussed in Part B below, these transition costs, while substantial, are well within the “rainy day” funds that the Society has designated for just such purposes.

The VP Finance in conjunction with the Associate VP Finance requests that the Policy Council pass a formal motion at its July 16, 2017 face-to-face meeting approving this transition budget.

Because this is such an important event in the life of the Society and because a number of complicating and interlocking factors are driving these budgets, the rest of this report is an extended explanation of the budget and the asset designations that support the transition from UAlbany to Cap Hill.

**A “Bridge Contract” of \$42,500 in 2017.** Once the decision was made to move our operations to Cap Hill the Home Office staff, in conjunction with the Administrative Committee began working on the details of how such a transition could be managed and financed. Early on, we realized that it would be a good idea to start working on some aspects of the transition that had critical timing or longer lead times. Hence, the Executive Director with guidance from the Administrative Committee signed a bridge contract with Cap Hill for \$42,500 to begin immediately work on five projects during 2017: (1) Support for a Legacy Campaign, (2) Transfer of Web Portal and Material to a New Commercially Supported Platform, (3) Transfer Financial Accounting to a Platform at Cap Hill by January 1, 2018, and (4) Develop Budget and Scope of Activities for 2018 and 2019 SDS Budgets and Contracts, and (5) Provide Support for the 2018 Conference in Iceland.

**Overall Logic and Process Used to Develop the 2019 “steady state” Budget.** The logic that we used to develop this two-year budget was to begin by envisioning a steady-state condition when Cap Hill was fully running the show. We would then “back into” the transition dynamics of how to get there. This process began with the contract that had been negotiated by the Transition Committee and approved by the Policy Council and proceeded in several steps. We:

1. Took the 2017 budget, organized by major categories, and rolled it forward by two years using the measured historic rate of annual growth or decline for the past five years.
2. Constructed a grand total for the work being done at Cap Hill by using the quoted figure for labor given in their proposed contract and adding in non-labor amounts (postage, direct IT costs, etc.) as they appeared in the most recent UAlbany contract. This amounted to about \$24,000 above basic labor costs of \$328,000.
3. Plugged this constructed cost at Cap Hill line into the rolled forward budget and discovered that this first cut plan yielded a deficit of about \$30,000.
4. Engaged in a series of give and take discussions with budget and contract leaders at Cap Hill until projected Net Ordinary Income was positive.
5. Added back in \$9,220 for Estimate Continuity of Employment so that the Society could meet its on-going obligations to its current graduate assistant, a PhD student who has been working with us for several years.

We believe that the balance reached in this 2019 budget provides the Society with a solid financial basis for moving forward in its work with Cap Hill.

**Overall Logic and Process Used to Develop the 2018 “transitional” Budget.** The short run transition budget is less clear and more expensive. The 2018 transition budget is complicated by a number of factors:

1. A contract with UAlbany runs from January to August and a second contract with Cap Hill runs from September to December.
2. Uncertainty exists about who will be the new Executive Director and when she or he will come on board. We expect that Michael Breslin will be a strong internal candidate, but the final selection will be made in a national search that will be staffed by Cap Hill.
3. Roberta Spencer expressed an interest in continuing on with the Society on a half time basis for two or more years. This is good news, but how should her new assignment be budgeted for?
4. There will be substantial amounts of time, effort, and cost needed to “button up” Home Office operations at UAlbany. It would be near disastrous if the Society had to move its operations any time between now and the end of the Iceland conference.
5. There will be substantial amounts of time, effort, and cost needed to “ramp up” operations at Cap Hill.
6. There will be substantial costs associated with Continuity of Employment for our current employees. These costs include factors such as: Costs of retraining employees, costs associated with a new Executive Director (hiring and/or overlap costs), costs required to re-integrate employees into a new pattern of operations at Cap Hill, and severance or other costs associated with retirement and/or separation from UAlbany<sup>1</sup>.

All of these factors produce transition costs that are hard to predict because the resolution of all these issues involves hopefully cooperative actions being taken by the Society, by Cap Hill, by UAlbany, and by our outgoing and on-boarding employees.

We expect that there will be substantial amounts of work on a one time basis during 2018 and in order to insure continuous and smooth operations during this period, the current budget extends the bridge contract from 2017 into the first 8 months of 2018 at the same monthly rate. The scope for this 2018 contract will include:

- Complete all forward motion on all five projects begun in the 2017 bridge contract.
- Run the search for a new Executive Director in a manner that appropriately involves the governance of the Policy Council.
- Take on major responsibility for the Iceland conference, freeing our Home Office staff to wrap up operations at UAlbany.
- Provide a written plan for dealing with the Continuity of Employment issue. This plan will be reviewed and approved by the Administrative Committee and Cap Hill will work with existing staff to implement this plan during 2018. This scope item involves Cap Hill as a strong partner in managing what may be the largest cost risk in the transition.

In sum, the budgeted contract with Cap Hill for 2018 was constructed by rolling forward a modified bridge contract at the same monthly rate as 2017 for the first 8 months of 2018 and the

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<sup>1</sup> These continuity of employment costs could be very low, if managed well. Our pessimistic estimate of \$116,000 was arrived at by approximating what would have been the Society’s cost of holding these employees for the last four months of 2018 as operations moved to Cap Hill. This seems to bound an upper limit of possible costs.

applying the monthly rate from the 2019 “steady state” contract for 2019. A substantial, pessimistic, estimate of continuity of employment expenses forms the final piece for the overall contract.

**Summary of Total Transition Costs 2017-2019.** Table 1 below summarizes budgeted total transition costs (well, almost—it does not include some costs incurred in 2016 due to employee turnover). The “Cap Hill Contract” costs represent the two bridge contracts with Cap Hill discussed above. The “Overlap of Executive Director” is an estimate of what we might have to pay as a new Executive Director comes on board before Roberta leaves her post. Of course, this cost could go to zero if there were no overlap as would probably be the case with an internal candidate. As discussed elsewhere, Continuity of Employment is the most volatile transition cost ranging between as low as \$30K and as high as \$116K. The Continuity of Employment expenses for 2019 are associated with support for a Ph.D. student currently working in the Home Office.

<b>Pessimistic Scenario</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>Total</b>
CHMS Contract	\$42,500	\$48,571		\$91,071
Continuity of Employment		\$107,008	\$9,220	\$116,228
Overlap of Executive Director		\$9,000		\$9,000
	\$42,500	\$164,579	\$9,220	<b>\$216,299</b>
<b>Optimistic Scenario</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>Total</b>
CHMS Contract	\$42,500	\$48,571		\$91,071
Continuity of Employment		\$21,000	\$9,220	\$30,220
Overlap of Executive Director		\$0		\$0
	\$42,500	\$69,571	\$9,220	<b>\$121,291</b>

**Table 1:** Summary of Total Transition Costs for SDS Move from UAlbany to Capitol Hill Management Services (CHMS)

In sum, overall transition costs could range between \$121K and \$216K, depending on how well we can manage continuity of employment matters. While these are big amounts, even scary amounts, they are well within the scope of the Society’s planned for “rainy day funds” as discussed in Section B below.

**Providing Continuity of Employment for the Society’s Current Employees.** As is evident in Table 1 above, the largest financial uncertainty in the transition budget is associated with “Continuity of Employment” for the Society’s current employees. What are these costs?

When the Home Office staff began working on transition issues, we took the stance of being as open and transparent as possible with all our employees and of assuring them that their interests would be taken seriously as possible. We would do our best to look out for the professional and financial interests of all our employees and this pledge extended through the end of 2018, the year of transition.

Why did we do this? There are several reasons:

1. This was the approach that we first discussed early on with the Administration Committee. These were our early “marching orders.”

2. It is the right thing to do.
3. Maximizing knowledge transfer from UAlbany to Cap Hill insures to the extent possible smooth and effective operations of the Society through a combination of personal and organization learning.
4. Perhaps most importantly, our strategy minimizes the “horizon effect”. This effect occurs when agents change their current behavior because of some future-anticipated events on or just over the horizon. A concrete example would be employee resignations just before the transition—just before or during peak work associated with the Iceland Conference. We have already had some experience with this effect when in late 2016 and for the first time ever, a longtime employee resigned on short notice.

A final and perhaps the most important question is how do we plan to manage continuity of employment expenses? We are taking a team approach, working with our new partners at Cap Hill. Cap Hill has agreed to include a scope of work item in its 8 month 2018 contract. This scope stipulates that Cap Hill will work cooperatively with the Home Office staff to craft a plan for each employee that best meets the joint needs of that employee, the SDS, and of Cap Hill.

If this plan leads to retirement for the employee, there will be no associated costs. If it includes the employee’s full and fast integration into Cap Hill’s operations, there will be minimal costs. If this reintegration involves reasonable re-training or reintegration costs, these will be picked up by the Society. This item of planned work by Cap Hill will create a written transition plan that will be reviewed by the Society by June 1, 2018.

Using this approach, we expect that continuity of employment expenses will be close to the optimistic scenario presented in Table 1 above. Recall that the budget presented in Attachment 7 is based on the pessimistic scenario which presented an upper bound based on the total salary file for the last 4 months of 2018.

## **Part B: Designated Uses of Society Assets**

For the past several years, the last page of every annual report of the VP Finance has been dedicated to enumerating the restrictions and designations on capital assets held by the Society. The purpose of these designations has been to provide for prudent cash reserves in the form of “rainy day” funds and to clearly delineate how designated funds may be used for limited purposes in the next budget year (e.g., support the Ph.D. luncheon, or provide support for the Field Development Fund). For the past several years, these designations have transferred \$29,000 from capital funds to selected current expenditures.

The summary of assets and their designations are presented in Attachment 8—Investments-at-Glance. Below are five important points relating to this attachment:

- (1) Assets used to support the Dana Meadows Award are temporarily restricted by donor specification. All other items are designated for support from Investment Income; approved by (and hence can be changed by) a vote of the Policy Council.

(2) Overall, our rainy day fund designations are significantly greater than even the most pessimistic estimates of the transition costs that we are facing. So we will get through an expensive transition and still be in sound fiscal shape.

(3) We are still carrying a designation to cover one year of Roberta Spencer's salary that is designed to reimburse UAlbany for any expenses that it may have had IF the Society had an adverse separation from UAlbany leaving the university with on-going obligations to Roberta (she had been granted continuing appointment at the University). Since it is now highly unlikely that the separation will be in any way contested, we should expect that next year there will be no further need to hold this designation after 2018.

(4) Income from the Legacy Campaign (see Part III of this report) is intended by specification of the campaign's core founders to be designated for use in support of the goals of the Campaign: Specifically, the Campaign will promote the long term growth of the field of System Dynamics by focusing on four goals:

- a. Promote high quality work in the field
- b. Promote the discovery and exploitation of high impact domains for System Dynamics work
- c. Recruit and encourage project champions with a vision to promote System Dynamics work
- d. Encourage global dissemination of System Dynamics work

These goals are part of a dynamic hypothesis articulated by GP Richardson in his paper "Drawing Insights from a Small Model of the Growth of a Management Science Field", presented at the 2014 ISDC. This model was commissioned as a challenge by Jay Forrester, who actively participated in the discussions that led to the creation of the model. The Legacy Campaign's core founders are those persons who participated in the development of this small model at the discussions hosted by Jay Forrester as well as several senior members of the field who contributed insights to the model.

The Legacy Fund will work to implement those goals by:

- a. Promoting a select series of special projects aimed at one or more of the Fund's goals
- b. Supporting a small secretariat that can convene practitioners in our field to focus on and refine these goals.

(5) Funds to support Roberta Spencer are shown as being transferred from designated funds (the Legacy Fund) to an item in the regular operating budget (Roberta Spencer Special Projects). This is the same mechanism that we use to authorize other regular expenditures that are supported by designated assets (for example as in the Ph.D. luncheon).

The VP Finance in conjunction with the Associate VP Finance requests that the Policy Council pass a formal motion at its July 16, 2017 face-to-face meeting approving this page of designations.

**Attachments:**

**(1 through 6)** Reports for the year 2016 contained and described in Part I of VP Finance Report

**(7)** 2018 and 2019 Proposed Budget System Dynamics Society

**(8)** Investments-at-a-Glance as of December 31, 2016

**(7) DRAFT 6/27/17**  
**System Dynamics Society**  
**2017 Budget Revised compared to 2018 and 2019 Budgets Proposed**

	<b>Budget 2017</b>	<b>Proposed Budget (with % increase as in 2019) 2018</b>	<b>% inc on 2017 budget or 3yr ave</b>	<b>Proposed Budget (developed with CH 5/31/17) 2019</b>	<b>% inc on 2018</b>
<b>Ordinary Income/Expense</b>					
<b>Income</b>					
<b>INC Conferences</b>	305,851.00	308,909.51	101%	311,998.61	101%
<b>Journal Income</b>	85,173.00	85,173.00	100%	85,173.00	100%
<b>Membership Dues</b>	70,866.00	71,574.66	101%	72,290.41	101%
<b>Products</b>	50,891.00	48,855.36	96%	46,901.15	96%
<b>Shipping and Handling Income</b>	8,169.00	7,188.72	88%	6,326.07	88%
<b>Sponsor Dues and Donations</b>	42,566.00	51,079.20	120%	61,295.04	120%
<b>Summer School Income</b>	9,300.00	11,160.00	120%	13,392.00	120%
<b>Total Income</b>	572,816.00	583,940.45		597,376.27	
<b>Cost of Goods Sold</b>					
<b>Cost of Goods</b>	9,331.00	9,517.62	102%	9,707.97	102%
<b>Total COGS</b>	9,331.00	9,517.62		9,707.97	
<b>Gross Profit</b>	563,485.00	574,423.00		587,668.00	
<b>Expense</b>					
<b>Awards-Dana Meadows</b>	2,000.00	2,000.00	100%	2,000.00	100%
<b>Awards-Others</b>	6,000.00	6,000.00	100%	6,000.00	100%
<b>Bank &amp; CC Fees</b>	12,232.00	13,088.24	107%	14,004.42	107%
<b>Field Dev (\$20K Max)</b>	20,000.00	20,000.00	100%	20,000.00	100%
<b>Contracted Expenses UAlbany</b>	357,084.00	229,804.41		-	
<b>Contracted Expenses CHMS</b>	42,000.00	162,394.86		352,454.00	
<b>R Spencer Spec Projects</b>		15,696.80		47,090.40	
<b>EXP Conferences</b>	145,900.00	151,736.00	104%	157,805.44	104%
<b>Insurance</b>	5,666.00	6,232.60	110%	4,110.37	Bus Owne
<b>Journal Expense</b>	20,000.00	20,000.00	100%	20,000.00	100%
<b>Ph.D. Luncheon</b>	1,000.00	1,000.00	100%	1,000.00	100%
<b>Miscellaneous Expense</b>	846.00	1,015.20	120%	1,218.24	120%
<b>Office Expense</b>	5,171.00	5,171.00	100%	5,171.00	100%
<b>Officer Expenses (=Travel CPA)</b>	7,423.00	7,794.15	105%	8,183.86	105%
<b>Professional Fees</b>	48,956.00	47,080.00	110%	12,000.00	CPA+Bibli
<b>Est. Continuity of Employment</b>		116,008.60		9,220.00	
<b>Summer School Expense</b>	7,710.00	9,252.00	120%	11,102.40	120%
<b>Total Expense</b>	681,988.00	814,273.85		671,360.12	
<b>Xfer Designated/Restrict. Funds to Support     Current Expenses</b>	29,000.00	44,696.80		76,090.40	
<b>Net Ordinary Income</b>	<b>(89,503.00)</b>	<b>(195,154.05)</b>		<b>(7,601.72)</b>	
<b>Other Income/Expense</b>					
<b>Other Income</b>					
<b>Investment Income</b>	78,425.00	82,346.25	105%	90,786.74	105%
<b>Est. Legacy Campaign</b>		15,696.80		47,090.40	
<b>Net Other Income</b>	78,425.00	98,043.05		137,877.14	
<b>Xfer Designated/Restrict. Funds to Support     Current Expenses</b>	(29,000.00)	(44,696.80)		(76,090.40)	
<b>Net Income</b>	<b>(40,078.00)</b>	<b>(141,807.80)</b>		<b>54,185.02</b>	



# System Dynamics Society

## (8) Investments-at-a Glance

### 1. Investment Goals and Designated Net Assets for the System Dynamics Society

		Goal Amounts as of Jun 30, prev year		Designated Net Assets as of Dec 31st each year	
		for 2017	for 2018	2016, Actual	2017, Est.
<b>Reserves for Rainy Day Expenses</b>					
	Capital Reserve	500,000	500,000	225,387	239,215
	Executive Director's Salary Reserve***	116,866	119,790	116,866	118,580
	Operating Surplus/ "Buffer Funds"	100,000	100,000	100,000	100,000
<b>Sub-total Reserves-Rainy Day</b>		<b>\$716,866</b>	<b>\$719,790</b>	<b>\$442,253</b>	<b>\$457,795</b>
<b>Reserves Budgeted for Operating Expenses</b>					
	Transition Costs				42,500
	Chapter/Field Development Fund	400,000	400,000	400,000	400,000
	Jay Wright Forrester Award	100,000	100,000	100,000	100,000
	Dana Meadows Award*	92,242	116,806	130,737	130,737
	Legacy Campaign	0	15,696	0	40,000
	PhD Luncheon/Support	20,000	20,000	20,000	20,000
<b>Sub-total Reserves-OpExp</b>		<b>\$612,242</b>	<b>\$652,502</b>	<b>\$650,737</b>	<b>\$733,237</b>
<b>Fair Value of Financial Instruments at year end**</b>		<b>\$1,329,108</b>	<b>\$1,372,292</b>	<b>\$1,092,990</b>	<b>\$1,191,032</b>

\*Classed as Temporarily Restricted Net Asset. Currently designated assets exceed amount needed to fund award.

\*\*Previously Total Assets/Equity

\*\*\*This designation no longer needed after move from UAAlbany to CHMS

### 2. 2018 Budget expense items designated for support from Investment Income

Chapter/Field Development Fund	\$20,000
Jay W. Forrester Award	\$6,000
Dana Meadows Award	\$2,000
Legacy Campaign (R Spencer Special Projects)	\$15,696
PhD Luncheon/Support	\$1,000
<b>TOTAL</b>	<b>\$44,696</b>

### 3. Investment Income for the year ended December 31, 2016

See CPA report, page 8--note (3)

**\$116,513**