

**Finance and Audit Committee
Report to the Executive Board
2013 Fall Meeting
Chicago, Illinois
Saturday – October 26, 2013**

Members of the Finance & Audit committee met with staff to discuss financial developments since the Annual Conference in Chicago, IL. The primary objectives of the meeting included a review and discussions on the following topics:

- FY13 Audit Update
 - 403 (b) Audit - EBD #4.2
 - Action Item**
 - Fair Value Reporting
 - Goodwill Impairment Analysis of Neal-Schuman
- FY 2013 Unaudited 3rd Close Results – EBD #14.1
 - General Fund Net Operating Results
 - Action Item**
- FY 2014 Total ALA Final Budget Review – EBD #14.2
 - Action Item**
- BARC Report – EBD #3.1
 - Action Item**
- New Business Development
- Controller’s Report – EBD #4.3
- Director Of Financial Reporting and Compliance – EBD #4.4
- Endowment Trustees Report – EBD #13.1

FY13 Audit Update – EBD #4.2

The committee was joined by John Fedus, Jeff Delheimer and Gary Meade from Mueller & Company to report to the committee on various aspects of the FY 2013 audit.

Audit Report Update - John Fedus of the audit firm Mueller & Company joined the committee and provided an update of the status of the 2013 audit. ALA and Mueller staffs began the audit process in June. It was noted that the same audit

team on the FY2012 audit would be working on the FY 2013 audit. The consistency of the team will help to make for a smoother process due to the familiarity the operation and related personnel. Initial audit planning/work was completed between July 15 –19. It was also noted that Mueller staff was able to observe the recent book inventory count conducted by staff and its fulfillment provider PBD on August 29, 2013. Initial field work for the audit will begin on November 4 and should last about three weeks.

403 (b) Audit Report EBD #4.2 – Jeff Delheimer provided a summary of the audit results of the associations’ 12-31-12 403 (b) retirement plan. This audit covers the consolidated results of the ALA Retirement Plan’s statement of Net Assets Available for Benefits as of December 31, 2012 and 2011. Planning for the audit was conducted during the May/June timeline, while the actual audit work was completed in mid September. Mueller staff worked closely with Cynthia Vivian – Director of Human Resources - and her staff in Human Resources. The plan audit was completed with a Disclaimer of Opinion as permitted by 29 CFR 2520.103-8 of the US Department of Labor. The Disclaimer of Opinion allows for the information received from the plan administrator prior to the FY2010 audit as unverifiable for current audit purposes. However, this information was certified by the plan custodian (TIAA-CREFF). Accordingly, Mueller did not express an opinion of the financial statements related to the plan. It was further reported that there were no audit adjustments, no difficulties or disagreements with management. As a result the following action was taken:

F&A recommends to the Executive Board acceptance of the 403b Audit as presented by Mueller & Co. – EBD #4.2.

Fair Value Reporting – Gary Meade provided the committee with an update on the governing principles that they will be followed during the audit with respect to the valuation of the Neal-Schuman (NS) acquisition. He noted that the principles of acquisition accounting require that the acquisition be reported at fair value. Fair value will be impacted by new fair value standards ASC¹ 805: Business Combinations and ASC 350: goodwill and Other Intangible Assets. All tangible, intangible and long-lived assets are valued separately.

¹ Accounting Standards Codification

In determining the current enterprise value Mueller & Co. staff will be depending on the work of ALA's independent valuator Plante Moran². They will test their assumption related to the following:

1. Neal-Schuman earnings forecast for the next ten years
2. The conversion of the earnings forecast into free cash flow
3. The determination of the Weighted Average Cost of Capital for ALA
4. The net present value of the forecasted free cash flows
5. Review the reasonableness of the assumptions
6. Review projections against historical results
7. Review all mathematical computations for accuracy
8. Will propose journal entries

The intangible assets related to Neal-Schuman e.g. Distribution Relationship, Backlist, Trademarks/Brands, Non-Compete Agreements etc. will each be valued under prescribed standard valuation methods.

As a result of all of the above, consideration will be given to the possibility of goodwill impairment and the possible write down of intangible assets related to Neal-Schuman.

FY 2013 Unaudited 3rd/4th Close Results – EBD #14.1

G. Calloway provided the committee with a review of the fiscal year end results based on the 3rd and 4th close results.

Total ALA: Total ALA revenues for the period were \$49.8 million, which is (-5.5%) or \$2.9 million less than the budget of \$52.6 million, which compares to \$49.3 million last year. The shortfall was primarily a result of lower revenues in the General Fund, which was under budget by \$3.0 million (-9.5%) at \$28.6 million. Also contributing was lower interest income from the long-term investment fund, which was less than the budget of \$839,955 by \$318,791 (-38.0%) at \$521,164.

Total ALA expenses for the period were \$49.5 million, which is (-8.2%) or \$4.4 million less than the budget of \$54.0 million, which compares to \$49.4 million

² Plant Moran is in the process of testing the underlying assumptions that have been provided by ALA management.

last year. Significant cost savings were realized in the General Fund (\$3.0 million) at \$28.3 million and the Divisions (\$1.6 million) at \$13.6 million.

On an overall basis the net result was excess revenues over expenses for a gain of \$223,199 compared to a budgeted net loss of \$1.3 million.

General Fund Revenues – As stated earlier General Fund revenues for the period were less than budget by \$3.0 million (-9.5%), totaling \$28.6 million. Most of the shortfall was related to Publishing Services, which was less than budget by \$2.8 million (-17.6%) at \$12.9 million. Analyzing Publishing Services reveals that ALA Editions/TechSource accounted for most of the shortfall with revenues of \$5.0 million, which was less than budget by \$2.2 million (-30.9%). This was due primarily to lower than expected book sales for professional development and text books in Neal Schuman. Expected sales in these areas for July and August did not materialize. Huron Street Press reported lower than expected revenues of \$52,226 while expenses were higher than expected at \$203,309. Also contributing to the shortfall was lower revenue from Digital Reference of \$558,467 (-44.6%), due to the late standard acceptance by the Library of Congress (March 13) and Graphics of \$247,210 (-19.0%) due to a slow start at the beginning of the fiscal year.

On the plus side ALA TechSource reported revenues of \$938,114 on a budget of \$696,677 and was over budget by \$241,437 (34.7%). Also offsetting this lower revenue were positive results in American Libraries and Booklist. American Libraries reported revenue of \$694,735 or \$108,701 (13.9%) or more than budget of \$781,800 due to strong advertising in all categories. Booklist reported revenue of \$5.2 million or \$192,503 (3.8%) more than budget of \$5.1 million due to strong summer sales and year end accounting adjustments.

General Fund Expenses - General Fund operating expenses for the period were \$28.3 million, which was less than budget by \$3.0 million (-9.6%). As revenue did not materialize certain expenses were not incurred primarily in Publishing Services. Publishing Services reported expenses of \$12.4 million or \$1.9 million (-13.0%) less than budget of \$14.2 million. Two areas accounted for most of the savings – ALA Editions/TechSource and Booklist. ALA Editions/TechSource realized the most significant cost savings with expenses of \$5.5 million, which was \$1.3 million (-18.6%) less than budget. Expenses in Booklist were \$3.8 million, which is \$326,698 (-7.9%) less than budget due to adjustments in manufacturing, i.e. printing, binding, prepress etc. related to

lower revenue expectations. Digital Reference and Graphics were also less than budget by \$188,618 (-13.3%) and \$183,384 (-15.5%), respectively.

The result was an excess of revenues over expenses for a gain of \$296,773. It was noted however, that the goodwill analysis³ on Neal Schuman was yet to be completed and the results could have a negative impact on the Association's net assets. As a result the following action was taken:

F&A recommends to the Executive Board that since the FY 2013 budget results are better than anticipated, staff compensation should be given the first priority.

The committee wanted to commend the ALA staff and its leadership for the cost-cutting measures they undertook when a projected deficit was recognized early in the fiscal year. Additionally, to publically acknowledge the hard work and effort provided by the accounting staff in processing, examining, and analyzing the financial transactions in preparation for this meeting and the year-end audit. The information provided in the reports was viewed as timely and essential in helping the committee conduct its business and make well informed decisions.

FY 2014 Total ALA Final Budget Review – BARC #14.2

G. Calloway highlighted for the committee changes to the FY 2014 budget since the Annual Conference. In view of the FY 2013 year-end results, FY 2014 revenue expectations are conservative. As a result, management made several modest adjustments to the budget since the spring meeting. Some of the changes include:

- Incorporated approved grants received after the spring meeting
- Incorporated modest changes in several Divisions

After a discussion of the budget changes the following actions were taken:

F&A concurs with BARC and recommends to the Executive Board approval of the final FY 2014 Total ALA budget as outlined in 2013-14 EBD #14.2.

³ An analysis of the current value of the Neal-Schuman vs. its book value

F&A concurs with BARC and further recommends to the Executive Board that if FY 2014 budget results are better than anticipated, staff compensation be given the first priority.

BARC Report – EBD #3.1

Patricia Wand reported to the committee on the more work conducted by BARC over two days of meetings on September 17th and 18th. Priority items included the orientation of five new BARC members, finalizing the FY 2014 budget, addressing the role and responsibility of the Planning & Budget Assembly (PBA), as well as, the financial performance of Publishing Services. She noted that the discussions were very lively with active engagement by all members and staff. In all areas discussed, it was believed that there were good solutions with which to move in a positive way to the benefit of the association.

See BARC report - EBD #3.1 to see the actions that were forwarded to F&A:

- Approval FY14 final budget
- Approval of FY14 staff compensation as a priority based on final results
- Approval of PBA agenda
- Approval of time change and format for PBA meeting

New Business Development

Mary MacKay and Keith Fiels addressed the committee on the status of efforts in the new business development area. The committee has been reviewing its full range of marketing products and current/potential customers. E-Learning is an area of emphasis, particularly in the international market. E-commerce has generated over \$2.0 million over the last two years. As a result, e-commerce and the implementation of the e-commerce module are important. Additionally, a tracking function is being strongly considered in order to help users keep tracking of all of their various e-learning efforts. RDA is also providing an excellent opportunity for new development on the international front. Currently 32% of all new RDA subscriptions are coming from our international customers. ALA has a very high standing in the international community. Work is being done to create a website that is more users friendly and easily searchable i.e.

visual and interactive. A special mention was made regarding the planned participation of ALA in the Sharjah International Book Fair (SIBF). This is a ten day event held annually in the United Arab Emirates. The SIBF started since 1982 under the continued guidance and patronage of His Highness Dr. Sheikh Sultan bin Mohamed Al-Qasimi, the UAE Supreme Council Member and Ruler of Sharjah. The SIBF will cover the expense of four ALA staffers to attend.

Controller's Report – EBD #4.3

Joanne Lee - Controller, was present to highlight the Controller's report for the committee.

Audit Planning Year – Mueller & Co. has been retained to conduct their second audit of the ALA financial results for FY 2013. After a planning meeting preliminary work was conducted on July 23rd and final fieldwork is planned for November 4th – 22nd.

Total ALA Financial Position - On a year to year basis as of August 31, 2013 ALA's financial position (Net Assets) improved by \$1.5 million (4.9%) to \$32.1 million. The most significant influence was lower liabilities related to less deferred revenue and a decrease in long-term debt.

Cash Management and Bond Fund - Total cash and short-term investments at August 31, 2013 amounted to \$15.5 million as compared to \$16.4 million a year ago. The decrease was mainly related to the payment of the bank loan to JPMorgan Chase of \$647,500.

The Neuberger Berman bond fund investment balance is \$12.4 million at August 31, 2013, which is down from \$13.8 million from last year. This investment has produced over \$9.7 million in interest income since December, 1991 and the yield has been well above the yield from certificates of deposit at 5.0%.

The Association maintains a line of credit in the amount of \$2.5 million with JP Morgan Chase. As of August 31, 2013 there was no outstanding balance. There was one draw on September 3, 2013 for \$500,000 to meet operating needs. Repayment was made in full on September 24, 2013.

Deferred Revenue – As of August 31, 2013 deferred revenue totaled \$9.2 million. This is an increase of \$109,515 (1.2%) and is due to higher division conference

revenue related to two national conferences scheduled in FY14 and higher subscription revenue related to RDA and Choice.

Long-Term Debt – ALA has an outstanding loan with JP Morgan Chase in the amount of \$10.1 million. The first scheduled payment of \$647,500 was made on July 1, 2013 while interest is made monthly. Additionally, in order to meet this obligation management has been setting aside \$50,000 on a monthly basis from the operating fund.

Inventory and Credit and Collections – Information related to these two topics was covered in the controller’s report and were well within the acceptable levels for required reserves (excess and obsolete), aging of receivables and reflected no issues. It was noted that both inventory and accounts receivable balances have increased and will be monitored.

Liquidity Ratio – In conjunction with the JP Morgan Chase long-term debt covenants, the Association is required to maintain certain financial ratio – debt Service Coverage and Cash to Debt. As of August 31, 2013 the ratios are 2.86 and 3.62 respectively compared to the requirement of 1.1.

Director of Financial Reporting and Compliance Report – EBD #4.4

Denise Moritz, Director of Financial Reporting and Compliance, reported to the committee on information included in the Director’s report.

Form 5500 – These returns were filed with the IRS on July 18th and October 9th respectively.

Internal Controls – Improving internal controls is still very much a priority in the department. In July a sampling of transactions originating in SharePoint, ALA’s billing payment system were tested, and the initial results showed that there was 100% compliance. Appropriate and required approvals were made, supporting documentation was present and account coding was accurate.

Change Management Policy - Finance personnel is working with ITTS to develop and implement a Change Management Policy that works for ALA. Software to help in this area has been identified and will be purchased in FY 2014.

Cash Flow Projections – In an effort to better anticipate the Association’s cash needs and optimally utilize its line of credit, monthly/quarterly cash projections are now being prepared. As this is a new process it will be monitored and refined as we go forward. Projections were prepared for the FY 2013. Monthly and quarterly projections for FY 2014 will be prepared.

Endowment Settlement – In October 2013, \$396,351 was transferred from the Endowment Fund to the ALA operating account. This is a normal settlement process between the Endowment Fund activities for scholarships & awards and the ALA operating account. Future settlement will be conducted on a quarterly basis.

Bill Payment Process SharePoint – A test server has been set up and is now ready to implement necessary upgrades. This will minimize disruptions to the production environment and properly test changes.

Budget Process for FY 2014 – Beginning with the FY 2015 budget process all ALA departments, units and divisions will migrate from an excel environment to using a Prophix worksheet. The Prophix software system has a budget module which will serve as the budget template. Additional license and staff training has been planned.

Endowment Trustees Report – EBD #13.1

Keith Brown reported on behalf of Rod Hersberger – Senior Trustee the status of the ALA Endowment Fund. As of 9-30-13 the value of the endowment was \$35.7 million. This represents a YTD gain of \$3.0 million or 9.2%

The Trustees continue their year-long efforts to overweight equities in the portfolio and underweight fixed income. This has positioned the portfolio to take advantage of the long awaited increase in interest rates. In conjunction with this effort the Trustees hired a new manager that specializes in floating rate bonds.

F&A concurs with the Endowment Trustees and recommends to the Executive Board approval to increase the number of Endowment Trustees by one for a total of six.

Acknowledgement

On behalf of the Finance and Audit Committee we want to thank ALA Finance Staff - Greg Calloway, Keith Brown, Elaine Klimek, Denise Moritz, Joanne Lee, Jennifer Tam, Doris McKelvin, Abdullah Ali and Tihuana Spells - for all their help in preparing for and executing the meeting and activities of the 2013 ALA fall meeting.

Respectfully submitted,

Mario Gonzalez – Treasurer

Rob Banks

Michael Porter

Jim Neal

Patricia Wand – BARC Chair

