

The Finance Committee (FinComm) has prepared this document for the consideration of the full Board of Trustees, as we did last year. The FinComm helped the Board create early high-level guidance for management, known as the “financial envelope”, following a plan discussed in our joint board and management team-building meeting in Miami in February 2013. We developed the financial envelope and communicated it in June 2013. The establishment and communication of the financial envelope has helped establish clear expectations for the budget and made the budget process smoother this year. Greg Kapfer (CFO) and Lynn St. Amour (CEO) and her team have done a very good job developing and improving upon the proposed 2014 budget that the Board will discuss in Buenos Aires.

The financial envelope was communicated as follows:

- *"Keep it flat" as a general principle*
- *No increase in the number of employees or contractors (unless the contractors are directly due to / required by a particular grant)*
- *Limited growth in employee compensation, not to exceed the rate of inflation in the US and EU.*
- *No increase in spending of ISOC programs/projects (unless due to / required by / paid for a particular grant).*

The FinComm believes that the current 2014 budget is mostly ready for approval, with a few exceptions that are highlighted for the Board to discuss. We have also highlighted other changes or important financial points. ISOC leadership can execute on their 2014 budget and plans regardless of our decision on the final question below.

1. Informative: PIR Non-Recurring Revenue (\$10M)

Issue Summary: ISOC received \$10M from PIR on a one-time basis.

FinComm Commentary: No decisions on how to spend these funds are being made at this time. The FinComm is separately proposing how to invest these funds until such time as we are prepared to spend some of the money.

2. Informative: “Base Expectations” vs. “Stretch Goals”

Issue Summary: In past budget years there has been a tension between what the Board felt was a realistic financial target and what the CEO wished to set as goals for her team. This year the realistic targets are “Base Expectations” and the CEO has established “Stretch Goals” to incent her team to go above and beyond. Presumably, the CEO will tie management-by-objective (MBO) incentive compensation for her team to these stretch goals.

FinComm Commentary: This is a beneficial step that we support, and will lead to better forecasting, budgeting, and goal setting.

3. Informative: “Fulfillment Expenses”

Issue Summary: In past budget years it was difficult to understand how or why certain grant-related expenses in various departments (Regional Bureaus, Leadership, Strategic Development) were under or over budget, sometimes by large

amounts largely out of ISOC's control. This made it difficult to understand how a department or a grant program was performing financially. In a new approach, the 2014 budget will reflect the costs of executing a grant as a Fulfillment Expense rather than in the functional departments of ISOC. As a result, we hope to better understand the true financial costs and performance of functional areas and grants as separate matters.

FinComm Commentary: This is a beneficial first step that we support, and will lead to better forecasting, budgeting, goal setting, as well as improved comprehension of the true financial health of various programs. The Board, CEO, and CFO should continue to focus on financial tracking of grants in 2014 to find ways to improve the clarity of our understanding of grant program performance in 2014 and beyond.

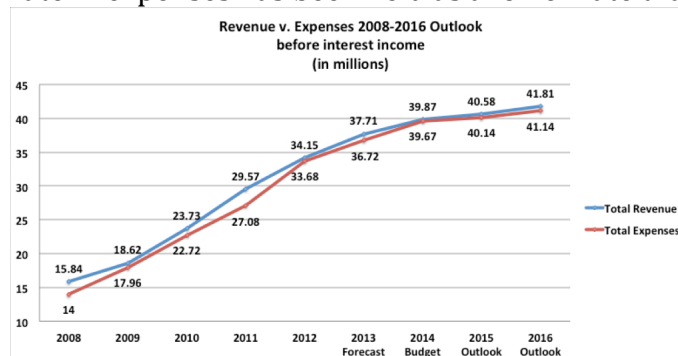
4. **Informative: Reliance on PIR Revenues**

Issue Summary: Revenues from PIR continue to represent our largest revenue source, at 75% of gross revenues in 2014.

FinComm Commentary: It is important to the continued health of ISOC that we not become overly reliant on any single source of revenue. Since 2011 there has been steady improvement here. Nevertheless, ISOC should improve the focus on revenue diversification, particularly as we now expect the growth in revenues from PIR to stop in future years (at \$29.5M/yr.). *Revenue diversification should be a key area of focus and measurable MBO goal for the new CEO.*

5. **Informative: Trend of Revenues vs. Expenses**

Issue Summary: In the past, the Board was concerned that revenues were growing at the same pace as expenses. In 2013 we made progress in this area as the growth rate in expenses has been held as a lower rate than revenues.



FinComm Commentary: This is proving naturally more difficult to manage as the rate of growth of PIR revenue slows. Relative expense growth should continue to be a focus in future fiscal years (and it can be helped via revenue diversification of course). *It is important to note that PIR revenues are projected to remain flat from 2014 to 2016, which means either all of ISOC's expenses must remain flat or we must find new or increase other existing sources of revenue. Non-PIR revenue growth should*

be a key area of focus and measurable MBO goal for the new CEO.

6. Decision: Staff Growth

Issue Summary: Personnel costs are ISOC's biggest single cost (>50%), and therefore a natural place to focus as the growth in our revenues slows or stops. ISOC added 16 staff in 2011, 12 staff in 2012, and 9 in 2013. Personnel costs are forecast at \$18.5M for 2014, up from \$12M in 2011 (54% growth in 4 years). Contrary to guidance in the Board's financial envelope, management proposes adding 3 new employees. At the same time, 1 position is slated for elimination, making the net impact +2 FTEs, for a total of 93 FTEs. [REDACTED]

[REDACTED]

FinComm Commentary:

1 – The Board carefully considered and drafted the financial envelope. One of the key directions from the Board was that there be no increase in headcount. As a result, the Board should stand firm and uphold our guidance for no growth in headcount, expecting that FTEs shall not exceed 91.

[REDACTED]

[REDACTED]

[REDACTED]

FinComm Recommendation: ISOC management is eliminating one position to decrease the number of FTEs from 91 to 90. We recommend that management select the most important and impactful new hire to make from the three proposed and fill that role to come back to a limit of 91 FTEs, in line with Board guidance on the financial envelope. No additional new headcount above 91 should be approved at this time.