

Standard Nine: Financial Resources

OVERVIEW

Northeastern's financial health has improved dramatically over the past decade.

Revenues have increased by 93 percent, outpacing the 83 percent increase in expenditures and providing significant resources to increase the endowment and address special initiatives and unexpected expenditures. The endowment has nearly doubled, going from \$382 million in 1997 to \$689 million in 2007. New investments have been made in academic areas, and financial aid to students has increased significantly. Overall, the University's financial position is quite strong, as recognized by Moody's recent A2 credit rating.

This standard is divided into three sections. The first describes the integration of the University's organizational structure with planning and budgeting, including the processes followed in achieving internal control over resources and reporting to external stakeholders. The second addresses the alignment of the University's resources with its mission and Academic Plan. The third describes and analyzes the university's financial position.

Integration of Organizational Structure with Planning and Budgeting

DESCRIPTION

Financial oversight. The University's financial affairs are administered by the Office of the Senior Vice President for Administration and Finance.

Northeastern operates on a fiscal year ending June 30 and prepares financial statements in accordance with generally accepted accounting principles. Budgeting and accounting oversight is provided by the Financial Affairs Committee (FAC) of the Board of Trustees. Financial statements are audited by PricewaterhouseCoopers, the University's external auditors.

The Audit Committee of the Board of Trustees oversees the work performed by both the external and the internal auditors.

The University's investments — excluding short-term investments of working capital, which are managed by the Office of the Treasurer — are under the supervision of a Board of Trustees subcommittee on funds and investments with the assistance of Cambridge Associates, professional investment managers. A subcommittee of the Financial Affairs Committee has oversight of facilities.

A system of internal controls is in place to safeguard the University's assets and ensure all funds are properly accounted for and expenditures are made with appropriate authorization.

The area has seen recent changes. In January 2007, a new Senior Vice President for Administration and Finance was appointed, resulting in a restructuring of the financial team. In addition, implementation of a new financial reporting and management systems became effective in July, 2008.

Operating budget. Northeastern currently employs a collaborative budgeting process, which has evolved over the past decade. It involves collecting input from the faculty, students, and the administration, as well as the Board of Trustees. This information is used to create budget drafts that are subsequently reviewed with these same groups. Ultimately, a draft budget is presented by the Provost and the Senior Vice President for Administration and Finance to the FAC in late January. Budget details may be adjusted before the board's final approval in March.

In addition to this centralized process, other, more detailed budget processes occur within the colleges. The School of Law and the College of Professional Studies currently operate on budget models that are based upon a dollar contribution return to the University. Measurement of performance against the operating budget is overseen by a combination of the Budget Office and the respective unit leaders.

Tactical and strategic planning. Financial projections are a key component of the University's overall tactical and strategic plans. Financial management translates the needs articulated in these plans into immediate and long-term claims on the University's resources.

Tactical financial plans are a key consideration in the development of the operating budget and the short-term capital budgets. Short-term capital budgets address the most immediate tactical needs, such as deferred maintenance, faculty and administrative office space, and classroom and laboratory renovations.

Strategic planning is a more involved, long-term process tied to academic planning. It includes five- to seven-year modeling to plan for faculty-hiring initiatives or for major facilities that address academic and student-life needs. Longer-term strategic needs have been funded largely with long-term tax-exempt borrowings.

Staff compensation. The University's salary budget and annual raise pool, if any, are determined by the President, with recommendations from the Provost and the Senior Vice President for Administration and Finance, and include considerations of general market conditions and the University's other financial commitments. The raise pool is articulated as a percentage of faculty and administrative salaries.

Faculty merit raises are determined by several different models, all based on performance evaluations and relative market data for the respective faculty position. For example, in the College of Arts and Sciences, each department elects a Merit Raise Committee from among its faculty. In the College of Business Administration, using a more centralized model, raises are determined by the Dean's Office in consultation with group coordinators.

To determine administrative salary increases, the performance of every employee is evaluated and individual salary increases are determined. Support staff and other weekly personnel receive salary increases on their anniversary date on the basis of their performance evaluations. Unionized staffs receive an amount negotiated by the University and union officials.

Advancement. Northeastern's development and advancement program is under the supervision of a new Senior Vice President for University Advancement who joined Northeastern in July 2007.

The University Advancement office recently adopted a hybrid model that divides fundraising

responsibility between its central operation and the individual colleges. The model, which places primary responsibility for private-source fundraising on the individual units, has greatly expanded the number of people involved in the fundraising endeavor by empowering deans, department chairs, and faculty members. As a result, the office's staff has increased by 20 percent.

The success of the advancement program is tracked through metrics for the following four areas: fundraising goals, new business development, collaboration, and stewardship. Fundraising goals are measured by determining whether the University has met its dollar goals. New business development is evaluated on the basis of donor progress — from acquisition, to increased giving, and ultimately to the giving of major gifts. Collaboration is achieved when college development officers and planned-giving officers develop shared strategies for reaching out to top prospects. It is also measured in the interactions among various colleges and departments as they pursue advancement goals together. Stewardship efforts have grown to include student participation, such as in thanking donors through phone calls and personal visits.

APPRAISAL

Financial oversight. The financial oversight committees of the Board of Trustees are composed of individuals with years of experience and special expertise. They include current and former CEOs, investment professionals, judges, regulators, and many other members of the business community. As part of their significant time commitment to Northeastern, they carry out a robust program of oversight of the University's financial operations.

The recent changes in the University's financial management team have added greater depth of financial management experience and resulted in more transparent reporting of financial information to the university community.

Operating budget. According to feedback from the constituent groups involved, the fiscal 2009 budget process was more participatory than in previous years and better addressed each constituency's priorities.

The budget models used for the Law School and CPS continue to encourage fiscal responsibility and innovation. In fact, the CPS model has given the school tremendous flexibility to achieve entrepreneurial growth over the past several years.

Ultimately, the entire University is expected to shift to some version of a decentralized model of academic management, which will place budget ownership closer to those who can most directly affect outcomes.

Staff compensation. The University has attempted to keep the salaries of faculty, administration, and staff competitive with the marketplace.

Faculty salaries are competitive at the assistant professor or new hiring level.

A system is in place to estimate market/equity shortfalls. For faculty, a matchmate system accomplishes this; the consensus in both the faculty and the Provost's staff is that it has worked reasonably and equitably. Merit raises for all employees have generally averaged about 3 percent per year over the past decade, only slightly above the rate of inflation, which has been a source of frustration for many. The University has been providing substantial equity pools to deal with the pressures of inversion and compression in senior faculty salaries.

Advancement. Although the hybrid organizational structure is in its infancy, it appears to be an improvement over the centralized model. Fiscal year 2007 was the most successful fundraising year to date, with total funds raised 50 percent over historical averages, and with 100 percent trustee participation.

The fiscal 2008 goal of \$45 million represents a 15 percent increase over 2007 and appears reachable, as fundraising progress as of early 2008 has exceeded 2007 by 5.3 percent and 2006 by 94 percent. Gifts of \$1 million or more have increased 50 percent since the arrival of the new Northeastern leadership. More than \$30 million in active solicitations is pending for the remainder of fiscal 2008.

The University currently has the challenge of educating students and newer alumni on the virtues of giving back. It has begun to emphasize helping the senior classes develop good donor habits; events held throughout the year encourage outgoing seniors to make reasonable contributions to their class and the University.

PROJECTION

Oversight by the Board of Trustees through its committee structure is likely to remain the same. Current and anticipated changes in the financial management team are expected to strengthen financial operations.

The implementation of the Sungard HigherEd Banner system should significantly improve the availability of financial information at all levels of the University. The information generated by the new system should make the budget-development process more participatory, and enhance the assessment of short- and long-term needs and the strategic allocation of financial resources to achieve the University's goals.

Within the next two years, the University plans to move to a more decentralized management model. This should increase unit-level accountability by giving units control of their revenues as well as their expenses. Also, it should allow Northeastern to become a more flexible organization, able to respond quickly to changes in its own needs and the needs of the marketplace.

The University is dedicated to advancing its reputation in the academic arena. With this goal comes the need to make faculty, staff, and administrative salaries fair and competitive. This has been accomplished at the new-hiring level, and steps have been taken to bring other salaries closer to market levels. The University is also dedicated to ensuring that budgeting and financial decisions related to academics are made in a meaningful collaboration with faculty.

Over the next few years, the University will continue to build and develop the centralized advancement staff members in an effort to strengthen the newly decentralized departments. Over the long term, the University will evaluate the effectiveness of the new advancement structure to determine the direction the department takes in future years.

A strong focus of the University is to increase alumni contributions and this will be accomplished by creating a stronger internal structure for developing donors. Donors will be developed from entry-level affinity status, through increased giving, and ultimately to a level of major and legacy giving that will elevate the University from its current tuition-dependent status. In the process, the University will expand its donor bases among alumni, friends, corporations, and foundations.

Relationship of Financial Operations to University Mission

DESCRIPTION

To further the goals of Northeastern's mission, financial resources are used to support academic endeavors, specific mission-oriented plans, and student-centered initiatives.

A substantial portion of University expenditures is devoted to academics. The percentage expended for instruction, academic support, research, and cooperative education has been 69 percent for the last two years.

Over the last decade, cooperative education has served as the cornerstone for the broader concept of experiential learning. In fiscal year 2007, approximately \$8.8 million was expended on cooperative education.

One of the ways that resources are being aligned with Academic Plan goals is through faculty-hiring initiatives. The resultant and projected hiring will continue to result in the growth and development of Northeastern's faculty.

Although the new professors joining the Northeastern faculty advance research efforts in many disciplines, four areas of existing strength are specifically targeted for enhancement. Three span the interdisciplinary sciences and engineering — biotechnology, nanotechnology, and sensing and imaging. The fourth area, urban affairs and public policy, encompasses interdisciplinary efforts in the social sciences and law. To further each of these areas, numerous centers have been established. For instance, to further the urban-oriented aspect of the mission the School of Social Science, Urban Affairs, and Public Policy was established within the College of Arts and Sciences with the mission of "bring[ing] together the best in social-science theory, empirical analysis, and public-policy research to address pressing societal problems."

Student financial aid is an important component of the University's student-centered mission. Northeastern offers a wide range of financial aid services. In fiscal year 2007, \$151 million in financial aid was granted, representing a discount rate of between 28 percent and 34 percent, depending on the type of measurement used. This represents a significant increase in the discount rate of the late 1990s, which was approximately 23 percent.

Approximately 47 percent of incoming freshmen receive some level of need-based aid. An increasing number of scholarships are awarded to address the urban mission, including scholarships for Boston Public Schools students and the new Torch Scholarships (see Standard Six).

APPRAISAL

Northeastern has increased its resources dedicated to growing and strengthening the professoriate by the hiring initiatives. Since Fall 2003 there has been a net increase of 54 tenured and tenure-track faculty members. These hires represent a major investment in raising the University's research profile.

Northeastern has also significantly increased financial aid to students. In the late 1990s, the university made a major decision to equalize the financial aid going to upperclassmen with that going to freshmen. During this four-year process, supplemental financial resources remaining for

other needs were meager. Nevertheless, University officials saw the equalization as the right thing to do. The decision has made Northeastern very competitive in offering financial aid. Its current discount rate is in line with the universities with which Northeastern competes for students.

PROJECTION

Northeastern will continue to devote significant financial resources to the academic mission over the coming decade. The faculty-hiring initiatives represent a large commitment of university funds. To date they have enhanced academic programs in three key areas: undergraduate education, core graduate professional programs, and centers of research excellence, as well as contributing to the base of interdisciplinary scholars at the University.

Other resources are being systematically reallocated from administrative functions to academic functions. Experiential learning, with cooperative education its keystone, will be funded in a manner consistent with its centrality to the University's mission and efforts are being made to expand its sub-areas of student research and service learning.

Financial aid will continue to be supported by significant financial resources. The University discount rate is not projected to increase beyond its present level, which is considered competitive in the University's marketplace. Financial aid's present mix — 69 percent need-based, 24 percent merit-based, and 7 percent athletic scholarships — will be monitored to meet evolving enrollment goals.

Financial Stability of the University

DESCRIPTION

The University's financial stability has improved steadily over the past decade. By virtue of its position as an urban research university in Boston offering experiential-learning opportunities through its unique cooperative-education model, Northeastern continues to be very attractive to prospective students.

There were 35,850 applicants for the 2,800 seats available for freshmen in September 2008. Graduate revenues have increased 60% over the past five years. These factors indicate the stability of the University's major operating revenue source (80 percent of revenues are generated from net tuition and room and board).

Northeastern has consistently operated on a balanced budget that includes investments to improve the academic enterprise and fully fund depreciation in order to meet deferred maintenance and space needs.

In fiscal year 2007, total unrestricted operating revenues grew by 10.6 percent, to \$610.7 million, and total operating expenses grew by 7.1 percent, to \$579.9 million, resulting in an increase in net assets from operating activities of \$37 million (compared to \$10 million in 2006). After deducting restricted assets, the unrestricted change was \$31 million, which represents a favorable variance of \$20 million over the \$11 million budgeted. Cash flows from operating activities were \$54 million, compared to \$38 million in 2006.

In addition, the University's endowment has increased an average of 11 percent annually over the past ten years to its 2007 level of \$689 million, largely from investment performance after an annual endowment payout of approximately 5 percent. When investment and advancement activities are included, the University's net assets increased by \$123 million. Tuition revenues account for 62 percent of operating revenues (<http://www.northeastern.edu/neuhome/aboutnortheastern/finalstatements.pdf>).

From 2006 to 2007, total assets increased by \$150 million, to \$1.65 billion, primarily as the result of increases in pledges receivable, investments, and new buildings. Total debt increased by \$29 million, mostly due to an increase in payables. The relationship of debt to net assets is 0.73:1.

The University recently underwent a lengthy review process to establish a public credit rating, resulting in its first A2 Stable rating by Moody's Investor Services. The process required Northeastern to demonstrate a solid, stable, and strong financial position to independent financial reviewers. Key financial and demand ratios such as these were examined:

	FY2003	FY2004	FY2005	FY2006	FY2007
Operating Margin	5.3%	2.0%	2.0%	2.0%	5.0%
Cash Flow Margin	15.3%	13.7%	13.6%	12.8%	14.8%
Debt Service to Operations	6.1%	6.6%	6.8%	6.6%	6.0%
Viability	0.93	0.99	0.87	1.03	1.20
Primary Reserve	0.94	1.04	0.94	1.03	1.09

	FY2003	FY2004	FY2005	FY2006	FY2007
Total Financial Resources (in thousands)	\$525,753	\$586,521	\$609,329	\$646,743	\$736,310
Expendable Resources (in thousands)	\$454,694	\$506,962	\$524,253	\$555,842	\$634,567

APPRAISAL

Northeastern has very disciplined and experienced senior financial management that understands that the key to financial strength is the capacity to carry out carefully considered plans. The financial planning and fiscal discipline mentioned throughout this standard are critical to the University's success. Attention to current and future needs has allowed Northeastern to grow strategically over the past ten years and continue to improve while maintaining a strong credit rating and solid annual financial statements.

In addition, the University has undertaken strategic borrowing to create a beautiful urban residential campus from what was a commuter school. Most of the borrowing (\$732.5 million as of June 30, 2008) has been for buildings that are revenue-producing; thus the costs are directly covered by paid fees. These revenue-producing buildings include residence halls and parking structures.

Borrowing is undertaken with a careful eye toward the impact on the University's financial statements. Because the University has an A2 credit rating, its bonds are investment-grade debt.

PROJECTION

Northeastern has made enormous strides in establishing systems to ensure strong student enrollment in the future. Nevertheless, the University needs to reduce its historic dependence on tuition to achieve all the academic goals of a top-tier research university.

Changes in advancement structure and philosophy begun over the past two years are already bearing fruit and should result in an increasing endowment and other resources that will cover more of the operating expenses. In fiscal 2007, 50 percent more funds were raised than in any previous year.

Several other factors bode well for the University's future financial strength. First, a new financial management team is effectively managing resources to build on the University's academic strengths. Second, new systems will soon allow managers to capture and use financial information in more efficient ways. Third, a transition to a more decentralized management system will allow individual units to create innovative programs for students and provide incentives and flexibility for doing so.

INSTITUTIONAL EFFECTIVENESS

Northeastern has in place appropriate mechanisms to evaluate and manage its fiscal condition. The budget process is balanced. It funds depreciation and consistently generates positive operating and cash-flow margins.

The award of the Moody's A2 rating gives an external validation of Northeastern's strong fiscal position and excellent management of its finances. Internally, financial resources have been aligned to support the goals of the Academic Plan. This process has been a collaborative one.