

Standard Nine: Financial Resources

Overview

Over the past decade, the College has grown significantly in available resources. The endowment increased from \$250.5 million on June 30, 1996, to \$578.2 million on June 30, 2005. Contributions to the College have also been significant. Total giving increased from \$18,195,771 in FY 1995–96 to \$38,147,672 in FY 2004–05 (TR9.1). Unrestricted gifts to Annual Giving grew from \$4.1 million to \$7.1 million in the same period.

Correspondingly, the operating budget and expenses of the College have grown. In 1996, the annual operating budget of the College stood at \$60 million, compared to a budget of over \$100 million in FY 2006 (TR9.2). As with many of our peers, tuition and fees have continued to grow, outstripping inflation and other economic indicators (TR9.3). Dedication of sufficient resources to the academic program and the student experience has remained paramount in setting priorities. At the same time, the Board of Trustees and senior management have reaffirmed their commitment to financial aid, both financially and programmatically (Standard 6). Finally, this decade has witnessed a significant investment in the College's physical plant through the acquisition of properties, the construction of new facilities, and major renovations. The College's capital expenditures are more fully discussed in the Financial Planning and Assessment section below and in Standard 8 regarding Physical Resources.

The Changing Budget and College Priorities

Overview of the budget process: The Treasurer's Office annually prepares the budget with the senior officers and President of the College, and in consultation with the College community. The Financial Planning Committee of the Board of Trustees meets frequently and provides valuable advice about the developing budget. In addition, a group of key budget managers across campus works closely with the Treasurer's Office in preparing budget worksheets and providing important analyses. Open meetings are held to share the preliminary budget with the campus community. The Financial Planning Committee votes to recommend the preliminary budget to the full Board, and the budget is now presented for final approval at the May Board meeting, rather than the February meeting as was the practice prior to 2003. Any revisions or adjustments to the fiscal year budget are presented to the Board at the October meeting. In addition to the Financial Planning Committee of the Board, a campus Financial Priorities Committee is briefed on the budget and discusses major policy issues during a series of meetings throughout the year. The Treasurer chairs the Financial Priorities Committee, which includes the President, members of the faculty, students, and administrative and support staff.

Presentation of the budget: Beginning in FY 2002–03, the College changed its presentation of the operating budget to a format based on sources and uses of operating cash, solely for purposes of planning and day-to-day operations. The presentation modifies generally accepted accounting principles (GAAP) by excluding non-cash items such as depreciation and including debt service principal payments. Designated and restricted funds are included as revenue to the extent that they are expended, rather than

at the date of their receipt. The Financial Accounting Standards Board (FASB) ruled in the early 1990s that operating results should include non-cash items such as depreciation, exclude debt principal payments, and consider all board-designated funds as unrestricted, regardless of how those funds ultimately will be used. While these rules attempt to provide consistency of financial reporting among colleges, they can be misleading for the internal management of operations. The sources and uses method of budgeting is designed to provide transparency of the College's cash position and an additional level of internal management reporting. Bowdoin's presentation of the operating budget is net of financial aid, which is deducted from gross tuition and fees. The sources and uses presentation includes as an expense the annual debt service on the College's outstanding bonds and notes (TR9.4).

As illustrated in Appendix 9.4, each year's budget document sets forth the recommended sources and uses of funds. Following the tables are line-by-line notes to explain each budget item, and a table documenting all sources and uses of operating cash, including capital expenditures of the College (equipment purchases, building improvements, etc.). The only capital expenditures not included are major new construction and renovation projects summarized in a separate capital funding plan (TR9.5).

For audited financial statement purposes, capital expenditures are treated as an asset, rather than an expense, and depreciated over time. These differences in the timing of the reporting of expenses are noted in the applicable sections of the budget and are reconciled to the audited financial statements in an appendix to the budget.

Since moving to the sources and uses format in FY 2002–03, the College has recorded three years of operating cash surpluses and is projecting balanced budgets in its five-year model. This surplus enabled the College to set up several important reserves, including a health claims reserve and an operating contingency fund. For example, the College ended FY 2004–05 positively with revenues exceeding expenses by \$1.5 million on total expenses of \$94.3 million (excluding depreciation and other non-cash items). Nevertheless, after adjusting for non-cash items, the College has recorded a financial statement operating loss (after depreciation) over this same period. While the College administration, Trustees, and rating agencies understand that the reason for the financial statement losses is primarily caused by the College not funding depreciation, they also recognize that important expenditures are budgeted for capital items in the capital/renewal major maintenance and IT equipment lines.

Overview of Changes in the Budget

In the five-year period from FY 2002–03 to FY 2006–07, Bowdoin's operating budget grew from \$87.1 million (actual) to \$105.3 million (budgeted)—a 20% change—while financial aid has grown 28% over the same period (from \$13.5 million to \$17.3 million).

The comprehensive fee (net of aid), unrestricted contributions, and the endowment distribution continue to make up the College's three major revenue sources. Together,

for FY 06–07, they constitute 81% of operating revenue. Payroll and benefits for faculty and staff are the largest category of expenditures at 60% of the total.

With the growth of Bowdoin’s budget over the past several years, the commitment to the academic program has been unwavering. The percentage of total expenses allocated to instruction and research has risen from 30% to 37% over the past decade. In addition, academic support (principally for technological resources, the Library, and the museums) has grown significantly over the same time, particularly in the form of major capital renovations to both the Library and the Museum of Art.

With respect to personnel, Bowdoin, like many of its peers within the COHFE cohort, has witnessed the steady growth of staff to support the academic program. For example, the number of laboratory support staff in the sciences grew from 10.47 FTE in 1996 to 16.69 in 2005. On the capital side, significant improvements have been made to classrooms, faculty offices, and other academic space. For example, during the past decade, the College added 133,517 new square feet for the academic program.

Revenue: Net tuition and fees as a proportion of total revenue has remained relatively constant, representing approximately 50% of total revenue (TR9.6). Auxiliary income accounts for another 5% of income in 2006–07. The annual distribution from the endowment will constitute approximately 22% of revenue; contributions, bequests, and designated funds another 18%. These percentages have been relatively stable over the past five years. For example, in FY 2000–01, the distribution from the endowment made up 20% of operating revenue as compared to 22% in the current year.

Expenses: Approximately 60% of the budget is spent on payroll and benefits for faculty and staff. With approximately 640 full-time-equivalent staff and teaching faculty of 170, the College expects payroll and benefits to cost \$63.7 million in FY 2006–07.

The College sets faculty compensation based on a long-standing policy known as 4-5-6. The Faculty Affairs Committee reviews the implementation of this policy annually (Standard 5). Unlike faculty compensation, staff compensation follows no prescribed formula. In recent years, pay increases have fluctuated, ranging from an average increase of over 5% in 2000–01 to 1.1 % in FY 2002–03 and 3% in FY 2004–05.

During FY 2002–03, a challenging economic period, the College eliminated approximately 30 positions through a combination of staff reductions, early retirements, and attrition. More recently, the College engaged Mercer Human Resources Consulting to assist in the reviewing the compensation structure and developing a new pay structure for staff. The project that began in 2004 and concluded in 2005 reduced the number of pay bands and recalibrated staff salaries according to current market salary survey data. After reviewing the data, Mercer found that Bowdoin’s overall pay structure was competitive. Their initial cost estimate of market-based salary adjustments was not anticipated to exceed .5% of base staff payroll or \$125,000 for FY 2005–06 (TR9.7).

Mercer’s review also reaffirmed that Bowdoin’s benefits package is very competitive as compared to the College’s peers. That package includes health insurance, a retirement

plan, a supplemental retirement plan, a tuition reimbursement plan, and pre-tax dependent care and health care accounts for its active employees. In addition, Bowdoin offers post-retiree health care and retiree health care to pre-65 retirees (TR9.8).

The College self-insures its point-of-service health plan but examines this decision annually. Over the past five years, the College's cost of maintaining quality health insurance has increased over 105%. In some years, benefit design changes have been implemented to help dampen the corresponding increase in premiums. In 2002, Bowdoin engaged Mercer to perform a study of the College's health benefits. That study concluded that the College should offer a single health plan (as opposed to two previously offered) and made several other recommendations, including the need to promote wellness initiatives within the community (TR9.9). Bowdoin continues to participate in many surveys to ensure that its benefit packages and offerings are competitive and reasonable.

Operational costs constitute the remaining 40% of operating expenses. Budget discipline over the past several years has kept operating costs relatively flat with little or no real increase in some categories. The one major exception to this has been the growth in the utility budget, discussed below. Because operating costs have remained relatively flat, several programs have experienced constraints, most notably in the Library.

As a result of adjustments to heating systems described in Standard 8, the College can respond to price changes in the spot and futures markets by switching between the two fuel sources. Over the past few years, utility expenses have posed a significant budget challenge. In October 2005, for example, the College had to increase its annual utility budget by 36%. Bowdoin has taken a number of practical steps to control costs.

While the heating plant accounts for approximately 35% of the utility budget, more than half of the utility budget is for electricity. In 2004 the College hired an energy consultant to make recommendations regarding energy use and conservation on the campus. Many of the report's recommendations have been adopted and are further discussed in Standard 8, Physical and Technological Resources. In addition, the College hired Competitive Energy Services to develop more sophisticated energy procurement strategies, including multi-year contracting, spot and futures market purchasing, and daily monitoring of the relative market price of natural gas and #2 heating oil.

Other efforts to control costs include streamlined procurement procedures, developing standard contracts, and establishing contracts with several vendors for preferred pricing. In 2003, the College retained Marsh USA Risk Services, Inc. to review its insurance portfolio and competitively bid its property and casualty coverage. This resulted in improved coverage at competitive pricing. The College has also streamlined its travel and vehicle use policies. Other efforts to streamline Requests for Proposals and to bid contracts competitively and engage in buying consortia have yielded significant savings.

Approximately 7% of annual expenses is dedicated to technology equipment and expenditures (Standards 7 and 8). Expenses relative to capital projects and deferred maintenance are covered in Standard 8, Physical and Technological Resources.

In the FY 2005–06 year, 6% of the operating budget was dedicated to payment of debt service. In FY 2006–07, debt service declines to 5% of the overall operating budget, due to a refinancing that took place in April 2006 (see Managing Debt below).

Financial aid to students has grown significantly over the past decade. From a sources and uses perspective, the operating budget is presented net of financial aid. In other words, the operating budget when combined with financial aid spending totals overall spending of \$122,635,000. From a financial statement perspective, the College's audited financial statements in June 1996 reported \$8.3 million of financial aid discounting on \$31.4 million of tuition and fee income (excluding room and board), or a 26% discount. By June 2005, financial statements reported \$16.1 million of financial aid on \$52.6 million of tuition and fee income (excluding room and board), or a 31% discount.

Endowment Management and Performance

Bowdoin's endowment is managed with the goal of balancing the conflicting goals of generating a steady stream of funds to support the current operations of the College while preserving endowment assets for support of the programs and initiatives of future generations of Bowdoin scholars. Using the basic tenets of modern portfolio theory, the endowment is diversified across multiple asset classes with differing correlations and risk and return characteristics. Bowdoin manages the endowment by allocating funds to external investment managers with expertise in specific areas of investment opportunity. No assets are managed internally at the College.

Bowdoin's endowment, at June 30, 2005, was valued at approximately \$578.2 million, representing endowment assets per student of approximately \$345,000. In FY 2006 the endowment supported 22% of the operating budget, with a spending draw of \$23.4 million. The College uses a 5% spending rule based on a 12-quarter average of endowment values. Approximately 40% of the endowment is restricted to use for scholarships and financial aid, with this percentage expected to grow with the current capital campaign initiative. Fiscal-year 2004–05 investment performance for the endowment was 13.6%, with three, five and ten-year annualized performances of 13.4%, 6.8%, and 11.5% respectively. In all time periods Bowdoin has exceeded the median return and has over the three- and five-year periods generated top-decile returns.

To enhance endowment performance and management, the College reorganized the Trustee Investment Committee and hired an internal investment manager in 2001. Led by the Vice President of Investments, the investment office is housed in the Treasurer's Office and is staffed by three professionals. In identifying potential investments, the College investment staff in collaboration with the Investment Committee carries out extensive due diligence, entailing both quantitative and qualitative research on market opportunities, investment strategies, and structures. The staff model also includes

handling the day-to-day operations of the endowment and working closely with the Controller's Office on investment accounting and back office processes.

Managing Debt

The College understands that debt is, in fact, leveraging the endowment. It is Bowdoin's policy to refrain from using debt to fund current operations. In that context, the College currently enjoys an Aa2 debt rating (TR9.10). As of May 2006, the College had \$113.1 million of long-term bonds outstanding, 89% at a fixed rate and 11% at a variable rate. Bowdoin issues long-term debt through the Maine Health and Higher Educational Facilities Authority. The current weighted cost of long-term capital is 4.60% and the average life of outstanding long-term bonds is 16.3 years. The College also maintains a \$10 million letter of credit facility to help manage cash flow and unanticipated expenditures. The College has an uncollateralized note payable and has three capital leases for the purchase of computer networking and equipment. In setting the appropriate level of debt, Bowdoin has established a debt subcommittee of the Financial Planning Committee. Among other issues, the subcommittee evaluates the cost of capital as compared to projected investment return on the endowment.

The two most recent bond issues occurred in 2005 and 2006. In 2005, the College issued \$30 million of debt to renovate six first-year residence halls and to partially fund a new recital hall (Standard 8). In 2006, the College issued \$9,375,000 par amount of bonds to refinance certain outstanding bonds, to take advantage of favorable interest rates.

Fund Raising

Achievement of the College's mission requires continuing growth in support from alumni, parents, foundations, and other resources for endowment, capital projects, and current uses. Over the past decade Bowdoin has successfully expanded that support, providing an excellent foundation for supporting the College's aspirations for the future.

In 1998 the College concluded its record-breaking New Century Campaign with \$136 million raised over five years. During the six post-campaign years (1998–99 through 2003–04), the College raised nearly \$185 million and almost doubled its annual giving program to over \$7.1 million. During that same post-campaign period, the Parents Fund grew from about \$500,000 to over \$1,000,000. The current campaign is scheduled to run through June 30, 2010, with a \$250 million target. Of this amount, \$158 million will fund endowment initiatives (principally financial aid) and close to \$100 million will fund capital and other spendable purposes.

These achievements were made possible in part by new initiatives such as a 50th Reunion Giving Program and the creation of an effective Major Gifts/Capital Giving program which has continued to grow. This program has been strengthened by careful oversight of the Planned Giving program and a resulting growth in Deferred Life Income gifts. The College has also increased foundation support (as well as faculty research grant support), in part by expanding the Corporate and Foundation Relations program. In preparation for

the current capital campaign, the College completed a 40,000-constituent record data conversion to new development software and established models for endowment fund reporting as well as donor stewardship initiatives. Efforts to enhance connections with alumni have also been crucial to the cultivation of sustained giving to the College. Two examples are the creation on campus of the Young Alumni Leadership Program (involving 40 students in 2005–06) to prepare seniors for alumni leadership roles, and a significantly enhanced Reunion Weekend program that integrates intellectual and family-oriented programming with class-specific celebratory events. Reunion Weekend attendance typically tops 1,700 alumni and family celebrants.

Financial Planning and Assessment

The College uses a five-year financial model to anticipate changes in the College's financial picture. That model was significantly revised in 2002–03 to conform to the sources and uses budget presentation. This model anchors planning discussions at the senior management and Trustee committee level. The tool is designed to be dynamic and is updated regularly as priorities and funding sources change. In January 2006, the finance staff produced a ten-year version of the model to provide a window into the long-term effect of endowment performance on operations (TR9.11 and TR9.12). The model currently includes the assumption of an on-campus student body of 1,700 FTE by 2009 and modest assumptions on the performance of the endowment, currently modeled at 7% per year, compared to actual performance over the past five, ten, and twenty years of 6.8%, 11.5%, and 12.3% respectively.

In addition to the ten-year model, the College developed a list of financial indicators in 2003. These indicators use key financial benchmarks to compare Bowdoin to many of its peers. Developed with input from the Financial Planning Committee of the Trustees, these indicators have been a helpful and meaningful way to evaluate Bowdoin's financial performance and results. (See TR9.13 for the most recent set of financial indicators.)

In addition to these planning and assessment tools, Bowdoin has invested in administrative software systems to improve the reliability and integrity of its financial data. Since 2001, the College has upgraded its administrative systems with Blackbaud's *Raisers Edge* and *Financial Edge* to provide integrated support for development and financial management and immediate access to financial data by staff and faculty. As noted in Standard 8, Human Resources/Payroll Departments are converting systems. The overall administrative systems improvements are expected to cost around \$3 million when complete.

Audit and Ethical Oversight

PricewaterhouseCoopers LLP (PWC) audits the College's financial statements (see TR9.2 for copies of audited financial statements and TR9.14 for copies of auditors' management letters). In addition to the annual audited financial statements, the College retains PWC to opine on the use of federal funds (principally financial aid and faculty

grants) and retains a local auditing firm to audit the College's retirement and health benefits plans (TR9.15).

In 2003, the Trustees' Audit Committee adopted a new charter to clarify its oversight role (TR9.16). The revisions resulted in large part from the sensitivities arising from corporate scandals such as Enron and the subsequent Sarbanes-Oxley Act of 2002. Although the Sarbanes-Oxley law is not directly applicable to non-profits, the charter was revised to address the role of the Audit Committee in relation to other Trustee committees, the committee's review of financial risk and institutional risk, and the role of the Trustees in relation to the independent auditors. Since these changes, the Audit Committee has become a much more active committee of the Board. Among other responsibilities, it regularly evaluates the work of the audit firm employed by Bowdoin.

In 2003, the College also adopted a Code of Conduct, approved by the Audit Committee of the Board of Trustees, which provides guidance on conflicts of interest and acceptance of gifts and sets forth whistleblower protection standards. The policy is available on the Web site at < http://www.bowdoin.edu/hr/handbook/02_general_policies/4697.shtml > along with other College policies at < <http://www.bowdoin.edu/about/admin/#> >.

In late 2004, the Audit Committee recommended that the College enhance its communication to employees regarding the Bowdoin College Retirement Plan and prudent investing. In 2005, the College revised the fund choices available to employees when selecting where to invest employee and employer retirement account contributions and provided information and education to employees (TR9.17).

In 2005–06, the College began an ongoing initiative to more thoroughly document its financial policies and procedures. An early success in this regard is the recently published grants manual (<<http://www.bowdoin.edu/faculty/cfr/grants-manual/>>). Other financial policy initiatives currently underway include a careful documentation of cash receipts and disbursements, investment of cash reserves, and the management of restricted endowment spending. The administration of more than 1,500 separate endowment funds can be a challenge, especially when fund terms become antiquated or impractical. Through a systematic review of funds and reformation of certain fund terms in the last few years, Bowdoin has broadened the terms of a number of funds. Efforts are underway to strengthen the internal audit functions at the College in the wake of the Sarbanes-Oxley Act of 2002 and SAS No. 60.

Institutional Effectiveness

Bowdoin is financially strong. Following the change to a sources and uses budget methodology, the College's finances are far more transparent and better managed than a decade ago. Resources have expanded significantly as a result of excellent returns on the endowment and significant successes with annual and campaign fund-raising. The College has used expanded resources to support its central mission, employing funds to enhance the academic program and the student residential experience.

Future budget challenges include rising utility costs, rising costs of health care and other benefits, maintaining competitive pay for faculty and staff, and funding capital renewal and deferred maintenance. In addition to establishing institutional contingency reserves, the College plans reserves to guard against increases in health care costs and utilities.

There will be continuing pressure to hold down increases in tuition and maintain a strong commitment to financial aid, and the Trustees and senior officers regularly reassess the costs of attending Bowdoin and the implications of those costs. We recognize that new program development cannot be solely supported by increases in tuition income. Nor can it be achieved by further expansions of the student body. Instead, Bowdoin will rely upon continuing expansion of fund raising and strong investment returns. Performance to date in both areas gives us confidence that the College can achieve both.

Nonetheless, the years ahead will challenge us to be clear about priorities in allocating resources. As we move forward the College will have to maintain discipline by not expanding staff and faculty without endowment support, continue to review and control financial aid spending, and maintain debt at relatively low or moderate levels.

The College's Planning and Development Office refines and assesses its ongoing program through the retention of a professional fund raising counselor, who annually reviews its staff, budget, programs, and fund raising and alumni relations results. In addition, the office submits its fund raising results to the Council for Advancement and Support of Education and the Council on Aid to Education and uses those organizations' comparative data to evaluate the success of its programs. The Chief Development Officer annually submits data to NESCAC schools and assesses Bowdoin's results in comparison to other programs in these frame of reference institutions.

Continued success in the College's fund-raising program will require the development of creative approaches and more sophisticated segmentation of our appeals to fund our many needs. These include fulfilling ongoing capital and endowment initiatives while sustaining significant growth in annual unrestricted giving; laying a foundation for future endowment growth through deferred giving; building better networking capabilities within the College's cross-departmental volunteer networks (Alumni Relations, Admissions, Career Planning); and implementing new technologies to strengthen our outreach programs. Bowdoin has a relatively small constituency compared to many of our peers, and our success will hinge largely on recognition of and response to ever-shifting alumni demographics (gender, ethnicity, geography, occupation) and on awareness of generational differences in alumni communication and connectivity.

