AY 2009-10 BUDGET ADVISORY COMMITTEE (BAC)
Minutes from the December 9, 2009 meeting

ATTENDEES
Dr. Alvin Thornton – Chair
Dr. Donald Bell
Dr. Charles Betsey
Mr. Rufus Blackwell
Ms. Carole Borggren
Mr. Rayford Davis
Dr. Philip Fanara
Dr. Barbara Hines
Mr. Thomas Lawson
Dr. Ivor Livingston
Ms. Roberta McLeod-Reeves
Mr. Roy Montgomery
Dr. Robin Newton
Dr. Joseph Reidy
Ms. Bridget Sarikas
Dr. David Schwartzman
Mr. Bryan Smart
Mr. Robert Tarola
Mr. Leon Wyden

Committee Staff: Mr. Cecil Trotman, Mr. Terrell Allen and Mr. Eugene Cooper from the Office of Financial Analysis and Budget.

2:08 p.m.
Dr. Thornton called the meeting to order and thanked Mr. Tarola and the Finance staff for their ongoing support in BAC meeting preparation and information review. The minutes were of the November 18 meeting were reviewed and approved. Dr. Schwartzman noted that the minutes from the 5/27/09 BAC meeting did not reflect that he dissented to the proposed 3% faculty salary adjustment. A motion was made, seconded and approved to revise the minutes to note that fact.

Dr. Thornton then called upon Mr. Tarola to make a financial presentation. Mr. Tarola noted that the presentation had only been shared with the HU cabinet and Board of Trustees. He also noted that some of the information in the presentation is not yet public, and would subject anyone using it for personal benefit to serious legal risks. He noted that all the information for FY2005-2009 came from the financial statements, but that the FY2009 financial statements are as yet unaudited.

Mr. Tarola then began a review of FY2009 financial results, and a five year profile of HU. He noted that there are three (3) primary revenue sources, Academic Services (Tuition, Auxiliary and Grants), Health Services (HUH and FPP), and Public Support (Federal Appropriation and contributions).

Mr. Lawson asked what category housed WHUR revenue. Mr. Tarola answered that this was picked up in “Auxiliary Revenues” under Academic Services. Dr. Schwartzman asked where endowment used for operating costs was located. Mr. Tarola identified this as “Other” under Public Support. Mr. Montgomery asked where room and board revenue was housed. The answer was “Auxiliary” within Academic Services.

Mr. Tarola pointed out that operating costs have grown approximately 4.3% over the last five years, almost twice the rate of growth of revenues. He also stated that Institutional Support costs
consistently run between $165 million and $175 million, and Howard’s costs are twice that of peer institutions on a per student basis.

Mr. Lawson asked what drove the growth in costs for employee benefits, which have grown twice as fast as salaries. Mr. Tarola answered that it was due to healthcare cost increases and retirement costs. Dr. Livingston noted that improved health consciousness could have helped drive healthcare costs down. Dr. Schwartzman asked where administrative costs were housed. Mr. Tarola answered that Institutional Support contains central services, such as information technology, finance and accounting, Human Capital Management (HCM), and the President’s Office. Administrative expenses for the schools and colleges are included under Instruction. Ms. McLeod-Reeves asked where leasing revenue was housed; it’s part of Auxiliary Enterprises. Ms. McLeod-Reeves then inquired as to the location of the VSIRP impact; Mr. Tarola replied that the full cost of the VSIRP was recognized in FY2009, which helped deepen the University’s financial losses.

Mr. Tarola stated that while FY2008 and 2009 were breakeven from an operating cash standpoint, Howard had operating losses as growth in expenses drove them higher than revenues. Mr. Montgomery asked what could have been done to prevent this negative trend. Mr. Tarola answered that while “Monday morning quarterbacking” was not productive, corporations and HU competitors took steps during the periods in question that HU did not. He noted that improved financial management is needed in all areas of the University, and questions and causes can be debated.

Mr. Tarola stated that, in the past, the federal appropriation has been used to keep all the rates Howard charges low, and it’s now time to discuss whether that should change. Dr. Schwartzman asked whether a study had been done on the impact of tuition rate increases over the past year. Dr. Thornton stated that the Tuition Rate Advisory Committee (TRAC) examines those issues each year.

Mr. Tarola then noted that net assets were hit hard by the decline in the stock market over the past few years. Dr. Bell observed that the net worth of HU’s financial assets has fallen by over $400 million over 2 years. He asked how this would impact the University’s course of action. Mr. Tarola said that this situation means that it would be difficult to generate funds needed to improve University facilities by issuing new debt. University managers must be creative in addressing future financial needs.

Mr. Montgomery asked whether HU took undue risks and liabilities in managing the investment pool. No, Mr. Tarola answered, and noted that the HU endowment was well-managed through the market turmoil. He stated that problems occurred in managing operating costs, and in anticipated revenue that did not materialize.

Mr. Tarola then pointed out that HU is currently cash-poor, having poor liquidity and limited financial flexibility. He identified some reasons for this as reinvesting in fixed assets and paying down debt. He stated that HU’s cash situation has benefitted from a pension payment holiday, and extending vendor payments. He noted that this is not a sustainable way to fund deficits.
Dr. Betsey asked for more detail on the “funding holiday.” Mr. Tarola explained that the University is required have pension fund investments to support the estimated obligations to current and future retirees. A substantial contribution to the pension fund was made in 2003, and during the ensuing several years strong market gains kept the value of the investments equal to or above the estimated pension obligations. However, the University must now make cash payments to the pension fund. Mr. Fanara asked if there was a negative financial impact associated with extending accounts payable, such as loss of early payment discounts, and late payment penalties incurred. Mr. Tarola stated that there was.

Dr. Bell pointed out that pension benefits are not at risk - pension requirements are secured and will be paid. Mr. Tarola stated that per the Employee Retirement Income Security Act – ERISA – the University is required to make sure of that.

Mr. Lawson noted that while private corporations don’t routinely offer retirees health benefits, universities commonly do, and postulated that this could hurt recruiting. Mr. Tarola noted that retiree healthcare has not been offered at Howard for many years, and noted that many corporations through multiple industries have been hurt by escalating healthcare costs.

Mr. Tarola then noted that public support, of which the major component is the federal appropriation, has been flat over the past five years. Contributions have also been essentially flat, which means that sources representing one third of Howard’s revenue have generated no growth to support inflation and other cost growth. He pointed out that the University’s biggest asset is the investment pool, which has been well managed during the recent market decline, but has been hurt. Also, endowment funds withdrawn for operations have exceeded new contributions over the past five years.

Referring to the FY2009 BAC process, Mr. Tarola stated that the FY2010 budget was originally developed assuming a $15 million deficit, when the actual deficit turned out to be much higher. Mr. Montgomery asked how the original $15 million figure was developed. Ms. Borggren answered that it was based on trend analysis, whereas the revenue shortfalls and cost items that drove the actual deficit did not occur until the end of the year. Mr. Tarola said that monthly financial statements with accruals for expected costs will prevent this in the future.

Dr. Livingston asked whether there was a “quick and easy fix” to the University’s financial challenges. Mr. Tarola replied that new funding from donors would be the easiest “fix”, and a second solution might be selling unneeded assets. Mr. Davis interjected that part of his charter would be to leverage more external information, and benchmark versus other universities in order to identify best practices to solve the long-term imbalance between revenues and expenses. Mr. Davis also stated that his organization will investigate external service providers, and make fact-based decisions. He observed that HBCUs have not been historically externally focused.

Mr. Lawson noted that some University services are already outsourced; giving as an example IT work that CISCO does at HU. He cautioned that outsourcing must be done effectively, and asked how the Board of Trustees will oversee quality improvements. Dr. Bell answered that BAC, due to its continuing nature, can give good counsel on directing resources.
Dr. Newton observed that the Faculty Practice Plan (FPP) has been trending well recently and shows potential for profit. She asked why FPP has been targeted to reassess its pricing policy. Mr. Tarola answered that since in FY2009 the University’s cost of providing patient care, which includes both the FPP and other costs, had exceeded patient revenue, this is an area that might benefit from further analysis. Mr. Lawson noted that FPP has ongoing billing and collection problems. Dr. Newton acknowledged this and stated that these issues were being addressed. She then reiterated the financial and other improvements at the FPP, and the importance of understanding that its future profitability depends on investments including additional medical faculty.

Mr. Tarola then laid out some of the challenges meeting the FY2010 budget, starting with the need for good reporting so that University managers can manage their budgets to target. He repeated the need to stop dealing with cash issues by paying vendors late. He stated that the current outlook shows that HU can achieve a breakeven cash position through short-term borrowing and budget discipline.

Mr. Lawson asked about the status and result of the McKinsey study undertaken by the University. Dr. Thornton answered that Mr. Davis would give a report on this at an upcoming BAC meeting.

Mr. Montgomery asked whether the revenue from President Swygert’s fundraising campaign was included in this analysis. Mr. Tarola answered that the bulk of the campaign activity occurred prior to the periods analyzed in his report.

Mr. Smart asked whether there were any plans to reduce administrative costs. Mr. Tarola answered that all areas would be reviewed and addressed accordingly going forward.

Dr. Fanara asked about interest rates the University is paying on its current borrowings, and whether there was room for more borrowing. Mr. Tarola answered that the interest rate charged in recent borrowings is quite good (55 basis points above LIBOR). He went on to say that Howard’s ability to borrow additional funds may involve borrowing against the value of the endowment, which the Board of Trustees may be reluctant to do. In the longer term our ability to borrow will depend upon our ability to get our expenses back in line with revenues, and to develop a well-thought out plan for identifying and financing our facilities needs. Mr. Tarola also mentioned $65 million in short-term loans coming due in FY2010 that must be paid.

Dr. Fanara asked whether enrollment was inelastic with respect to tuition increases, as assumed by the previous HU CFO. He ventured that the “best buy” strategy may not be best in the current economic environment. Dr. Bell answered that TRAC is currently analyzing this issue, and has recommended raising tuition. Dr. Thornton asked Ms. Borggren to coordinate a TRAC presentation to BAC. Ms. Borggren agreed.

Ms. McLeod-Reeves observed that long-term vendor contracts have the potential to keep HU from exploring other vendor opportunities that might result in cost savings. She gave as an example the Pepsi contract, noting that HU should receive more money for long-term commitments. Mr. Tarola stated that this was under Mr. Davis’ purview, and he would follow
Ms. Borggren noted that the Pepsi contract was competitively bid when originally adopted. Dr. Schwartzman observed that the Faculty Senate has called for the elimination of food on campus with high trans-fat and fructose corn syrup levels. He suggested that this might be incorporated into any new beverage contract negotiations.

Dr. Thornton thanked Mr. Tarola for the timely and detailed presentation, and observed that this sheds additional light on the findings on financial health in our self-study prepared for the Middle States Re-Accreditation process.

Dr. Thornton then provided a brief status report on the new initiatives funded by the BAC for the Provost Office in the FY2010 operating budget. He made note of $800 thousand of enhancements to the University Libraries, and $1 million for STEM Initiatives. With regard to capital, the Provost’s Office plans to proceed with $1 million of classroom and laboratory renovations, $500 thousand of Smart Classroom renovation, and $2 million of residence hall renovations. They are also finalizing the competitive process for awarding $3.5 million for the purchase of research equipment. He promised more detail on these measures during a full presentation in January 2010, and noted that other executives who received new FY2010 funding will provide similar reports.

Dr. Bell thanked Mr. Tarola for the finance presentation, and noted that the HU community needs information of this nature, and that it helps facilitate broad-based community understanding and decision-making.

Dr. Schwartzman asked that a glossary of financial and economic terms accompany a financial presentation of the nature given by Mr. Tarola to assist laypeople in getting more understanding of what was being presented. Dr. Livingstone suggested that this presentation be given as widely as possible and hoped Mr. Tarola could find time to share this information with deans and faculty.

Dr. Thornton stated that the next BAC meeting will be held January 27, 2010, during which the outcomes from the Faculty Senate’s FY2010 budget proposal would be addressed.

The meeting was adjourned at 3:54 p.m.
<table>
<thead>
<tr>
<th>TERM</th>
<th>DEFINITION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrual</td>
<td>An accounting method that ignores whether cash has been received or paid. This method considers revenues earned, but not collected in cash, and expenses incurred, whether paid in cash or due to be paid.</td>
</tr>
<tr>
<td>Asset</td>
<td>A resource of monetary value, including cash, accounts receivable, inventory, real estate, equipment, and securities</td>
</tr>
<tr>
<td>Balance Sheet</td>
<td>A financial statement that provides a picture of an entity’s assets, obligations, and net worth at a specific point in time</td>
</tr>
<tr>
<td>Capital Assets</td>
<td>Physical resources with a cost (or fair market value, if donated) exceeding an established dollar threshold that are expected to provide service for more than a single year. The cost of the assets is allocated to the fiscal years in which the entity is expected to benefit from the asset through depreciation. Examples of capital assets include land, buildings, equipment and building improvements.</td>
</tr>
<tr>
<td>Capital Budgeting</td>
<td>The process used to develop and monitor resources and investments related to large-dollar projects undertaken either to acquire or to construct capital assets such as buildings</td>
</tr>
<tr>
<td>Capitalization</td>
<td>The process of recording expenditures for long-term resources as assets rather than expenditures. Expenses are realized as costs of a particular period, while capital assets’ costs are recognized over time through depreciation.</td>
</tr>
<tr>
<td>Cash Flow from Operations</td>
<td>Net cash inflow resulting directly from regular operations (disregarding extraordinary items such as the sale of fixed assets), calculated as the sum of net income plus non-cash expenses that were deducted in calculating net income.</td>
</tr>
<tr>
<td>Depreciation</td>
<td>The allocation of the cost of tangible assets (such as buildings or equipment) as expenses to multiple fiscal years. The value of the tangible asset’s cost is divided by the number of years the asset is expected to provide benefits. The resulting amount is treated as an expense during each period. Depreciation is a non-cash expense.</td>
</tr>
</tbody>
</table>
## Glossary of Financial Terms (cont’d)

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liquidity</strong></td>
<td>The ability of a person or an entity to readily and easily obtain cash from its assets in order to meet obligations or make purchases.</td>
</tr>
<tr>
<td><strong>Liquid Asset</strong></td>
<td>Asset that is easily turned into cash, with little or no loss of value, notably cash itself and short-term securities.</td>
</tr>
<tr>
<td><strong>Net Asset</strong></td>
<td>The difference between total assets and current liabilities and non-capitalized long-term liabilities</td>
</tr>
<tr>
<td><strong>Operating Cash Flow</strong></td>
<td>Earnings before depreciation minus taxes. It measures the cash generated from operations, not counting capital spending or working capital requirements</td>
</tr>
<tr>
<td><strong>Operating Loss</strong></td>
<td>When operating costs are higher than operating revenues</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td>When operating revenues are higher than operating costs</td>
</tr>
<tr>
<td><strong>Operating Profit Margin</strong></td>
<td>The ratio of operating profit to operating revenue</td>
</tr>
</tbody>
</table>