THE BIENEN YEARS AT NORTHWESTERN

Northwestern University 2008 Financial Report

President Bienen (right) proved himself at ease with donors, enabling the University to achieve ambitious goals. Here he and McCormick School dean Julio Ottino (left) open the Ford Motor Company Engineering Design Center with Ford executives Charles Wu (second from left), Anne Stevens, and Joseph Hinrichs.

IN TRIBUTE TO PRESIDENT BIENEN AS HE NEARS RETIREMENT

Patrick Ryan (right) with Bienen

A message from the Chair of the Board of Trustees

When Northwestern University was seeking its 15th president, I agreed to head the Board of Trustees committee conducting the search. In the 14 years since we selected Henry S. Bienen, I never have doubted that we chose the right person for the time.

Henry, who will retire in 2009, has been both an exceptional academic leader and a remarkably successful steward of Northwestern's finances. Universities often choose between someone who can run a billion-dollar business and someone who can advance academic goals. In Henry, we got both: a world-class scholar and a very, very successful CEO.

It was clear during our interviews that Henry was definitely what we needed. He was the only candidate who said in answer to my question about fundraising that he enjoyed it. His predecessor, Arnold Weber, had left the University on a solid financial footing with a balanced budget, and the board felt that Northwestern was poised to take a place among the elite institutions of higher learning. To do so would require not just vision but also the resources to build state-of-the-art facilities, expand programs, increase research funding, and endow chairs that attract world-class scholars.

Therefore, a few years after Henry's arrival, we launched a fundraising campaign of a magnitude few universities had attempted. Campaign Northwestern aimed to raise $1 billion and then $1.4 billion and ultimately brought in $1.55 billion. The board expected Henry to be true to his word about enjoying fundraising, but his proficiency at it impressed us nevertheless. Having made sure he understood every academic area's scholarship, budget, and goals, he was able to pinpoint where needs might dovetail with donor interest. Henry proved himself a virtuoso at communicating with prospective donors. Knowing precisely where their dollars will go, particularly if they'll support a personal interest, can make the difference to donors who are being courted by multiple institutions.

After Henry informed us of his decision to retire, the Board of Trustees considered what would be a fitting legacy. Since Henry and his wife, Leigh, are music aficionados and attend many of the music school's concerts, we decided to name the music school and an endowment to support it for them. As I said on the day of the announcement last spring, the trustees, alumni, and friends of the University wish to recognize all the things that Henry has done for the entire University by building a lasting endowment to support one of the areas of the University closest to his heart.

But, in truth, no area of the University is not close to Henry's heart. He is a political scientist who led an expansion in biomedical and technological study. He has boosted research while stressing the importance of undergraduate teaching. He sees a stellar reputation for athletics as compatible with a stellar reputation for academics. He has striven for excellence across the University, with no department left behind.

I feel privileged to have served as Board of Trustees chair during the presidency of a man who, I believe, will be seen by history as one of Northwestern's most transformative leaders.

Patrick G. Ryan

HIGHLIGHTS OF THE BIENEN PRESIDENCY

State-of-the-art new buildings are evident on both campuses. In the last decade the University has constructed major academic and research buildings, including the Ford Motor Company Engineering Design Center, the Arthur and Gladys Pancoe–Evanston Northwestern Healthcare Life Sciences Pavilion, and the Medill School of Journalism's McCormick Tribune Center in Evanston and the Robert H. Lurie Medical Research Center in Chicago. The Richard and Barbara Silverman Hall for Molecular Therapeutics and Diagnostics is under construction in Evanston. There are also new classroom and faculty office buildings, as well as upgrades to many other academic buildings. Two more undergraduate residence halls have been built, and athletic facilities have been completely renovated.

1995

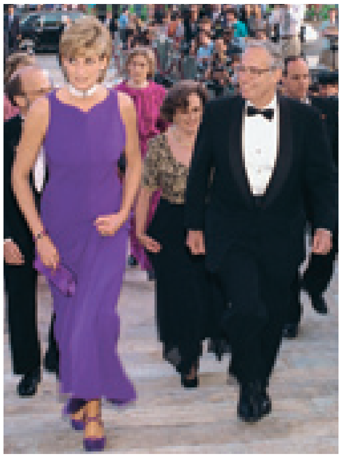
Henry S. Bienen takes office January 1 as the 15th president of Northwestern University. In the fall the Wildcats capture the Big Ten **football championship** for the first time in nearly 50 years and are headed for the Rose Bowl.

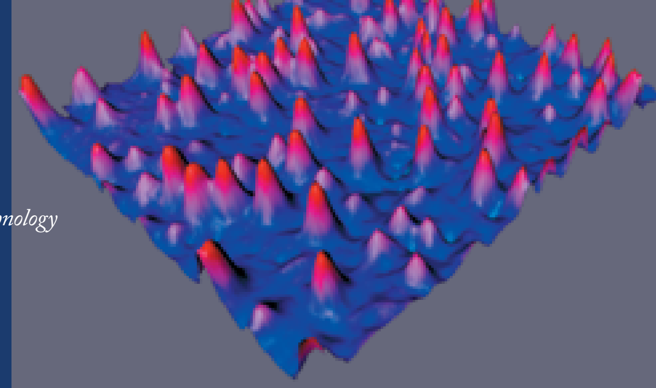
1996

Diana, Princess of Wales (right) **visits** campus to support breast cancer research. The Wildcats take a second straight Big Ten football title and will play in the Citrus Bowl.

1997

The newly **renovated football stadium,** renamed Ryan Field after the Board of Trustees chair, opens with a Wildcat win over Duke University.





Under Bienen, Northwestern became a world leader in nanotechnology research. At right: phase image of acrylic latex nanoparticles.

Research funding from outside sources has grown from $173 million to about $440 million last year. Hand in hand with that growth is a steady increase in the number of endowed professorships; 106 new faculty chairs have been added. The world-renowned scholars we attract for these most prestigious professorships bring with them their successful research programs.

Among the fields where Northwestern has attracted world-class scholars and emerged as a leader are biomedicine and nanotechnology. The University created the Center for Nanofabrication and Molecular Self-Assembly. It also entered into a collaboration with Argonne National Laboratory on the International Institute for Nanotechnology. On the Chicago campus, the sparkling new Robert H. Lurie Medical Research Center provides a modern setting where multidisciplinary teams research today's most challenging medical questions. When Silverman Hall in Evanston is completed, it will bring together chemists, biologists, and engineers to advance biomedical research through the development of new medicines and diagnostics.

1998

Campaign Northwestern, a **$1 billion fundraising effort,** is announced. With a new name, the Judd A. and Marjorie **Weinberg College** of Arts and Sciences honors major University benefactors.

CAMPAIGN NORTHWESTERN

2000

The University creates an Institute for **Nanotechnology** (right) under the direction of chemistry professor Chad Mirkin. Campaign Northwestern's goal is raised to $1.4 billion.

All across the University, not just in the sciences, Bienen has promoted collaborations. He was active, for instance, in building an umbrella program in Asian and Middle Eastern studies with new faculty, an undergraduate major, and course work for graduate students in history, art history, languages, and other departments.

While Bienen broke down borders within Northwestern, he has extended the University's borders. For a political scientist whose specialization is Africa, Bienen's global interest comes naturally, but the extent of Northwestern's current international reach is notable nonetheless. In 1997 only 4 percent of undergraduates studied abroad; today 30 percent do, including engineering and science students who typically didn't consider leaving campus in the past. The most dramatic example of Northwestern's globalization is our new campus in Qatar (below), where the University started programs in communication and journalism in fall 2008.

2001

Northwestern celebrates its **Sesquicentennial** (with customized M&M's [below right], among much else). The medical school is renamed the **Feinberg School** of Medicine after receiving more than $100 million in gifts from the Feinberg Foundation. The Medill School's new **McCormick Tribune Center** is dedicated. Benjamin W. **Slivka Hall,** a state-of-the-art residential college of science and engineering, opens. *BusinessWeek* names the Kellogg School of Management the **top graduate business school.**

2003

Citing **the work of the School of Law's Center** on Wrongful Convictions, Governor George Ryan declares a moratorium on the death penalty in Illinois. Campaign Northwestern ends after raising $1.55 billion.

2005

Bienen is among the first three university presidents to receive a Carnegie Corporation Academic Leadership Award. The Robert H. **Lurie Medical Research Center** is dedicated in the spring on the Chicago campus, and the **Ford Motor Company Engineering Design Center** (right) in the fall on the Evanston campus.

The University's endowment had quadrupled as of the end of fiscal year 2008. A prudently invested endowment helps us to plan Northwestern's future with confidence because it provides a dependable revenue source and safeguards us from fluctuations in research funding and in governmental student aid. The endowment supports professorships, scholarships, fellowships, research efforts, book purchases, visiting lectureships, and the myriad other needs of our schools and centers.

The University has improved what was already a topflight academic reputation. Northwestern students have received 24 Fulbright Scholarships and 10 Marshall Scholarships, as well as many Rhodes, Gates Cambridge, and Goldwater awards. Among faculty honors are the Nobel Prize in Chemistry, a Tony Award, five MacArthur "genius grants," the National Medal of Technology, and two National Medals of Science.

Our latest Rhodes Scholars are Anya Yermakova (left) and Mallory Dwinal.

2006

Nanofabrication laboratories are named Patrick G. and Shirley W. **Ryan Hall** after a gift from the Board of Trustees chair and his wife to support financial aid for students and medical research.

2007

The University endowment tops $7 billion, more than four times its size in 1995. It has been boosted by royalties from the drug **Lyrica®**, created by chemistry professor Richard Silverman (left, with wife Barbara) at Northwestern. Ground is broken for the Richard and Barbara **Silverman Hall** for Molecular Therapeutics and Diagnostics. Technology transfer revenues top $500 million.

The mean SAT score of undergraduates has risen 150 points, from 1272 in fall 1996 to 1422 in fall 2008. This year's freshman class had the third-highest number (249) of National Merit Scholars in the country. Superior students seek academic challenges; Bienen has placed a major emphasis on creating opportunities for undergraduates to do research. At the 2008 undergraduate research symposium, 135 students presented their work.

It's not just Northwestern's academic standing that has grown under Bienen; its athletic success has as well. Seventeen athletic teams have won Big Ten championships, including three in football and an unprecedented nine straight in women's tennis. Women's lacrosse (below) has won four straight NCAA national championships. The football team has gone to six postseason bowl games.

2008

Records are set for undergraduate applications (25,013, **double the number** of the year before Bienen arrived) and the size of the freshman class (2,078), whose mean SAT score has gained 150 points in Bienen's years. Northwestern opens a **branch campus in Qatar** with programs in communication and journalism. The women's lacrosse team wins its **fourth straight NCAA championship**. The music school is renamed the Henry and Leigh **Bienen School of Music** in honor of the retiring president and his wife. Research funding from outside sources reaches $440 million.

Northwestern's music school has been renamed for Bienen and his wife, Leigh (in center of photo).

Report of the Senior Vice President for Business and Finance

To the Board of Trustees of Northwestern University:

As shown in the financial statements, Northwestern has the resources to adjust during the downturn in the U.S. and world economies without compromising its core missions of world-class instruction and research. We have implemented strategies to stay fiscally strong, including expenditure reductions and deferral of some initiatives.

In fiscal year 2008, the University entered into a one-time sale of part of its royalty interest in the pain relief drug Lyrica®, which was developed in University laboratories, to Royalty Pharma for $700 million in cash. The net proceeds were placed in the endowment and invested in the Long-Term Balanced Pool. Northwestern's total investments increased to more than $7.1 billion and experienced a total return of 0.33 percent for the fiscal year.

The University continued to be successful in the debt markets. It issued $125 million in new variable-rate debt in June and increased its outstanding commercial paper to $200 million at August 31, 2008.

After terminating its agreement with its investment custodian to lend University securities, Northwestern held no collateral as assets and had no offsetting liabilities at August 31, 2008.

While total liabilities decreased 10 percent to $1.6 billion, total assets increased to $9.3 billion, up from $8.9 billion the previous year. Total net assets of $7.7 billion reflect an increase of $538 million, or 7.5 percent.

Unrestricted net assets increased $493.3 million to $6.7 billion. Largely the result of the monetization of the Lyrica royalty, operating revenues increased 59 percent, or $861.3 million, over fiscal year 2007. Operating expenses increased 15.6 percent, or $211.5 million.

Temporarily restricted net assets decreased by $18.3 million as the University expended net assets in accordance with donor restrictions totaling $51.4 million. This release of temporary restrictions was offset by $30.9 million in new temporarily restricted private gifts. Permanently restricted net assets increased $62.8 million, primarily as a result of endowment contributions received.

Northwestern is closely monitoring and responding to events in the financial markets and the economy at large. The University has managed through the turbulence of the first quarter of fiscal year 2009 without loss of liquidity or ability to market its debt. Our history of strong financial results and conservative budgeting practices provides a favorable foundation from which to continue to move forward even in uncertain economic times.

Eugene S. Sunshine

Eugene S. Sunshine
Senior Vice President for Business and Finance

As economic growth slowed from the past few years' torrid pace, global economies began entering into recessionary conditions during fiscal year 2008. Equities posted double-digit negative returns, with the U.S. stock market dropping 10.2 percent and foreign equities declining 11.9 percent. A few asset classes had significant price increases despite challenges, however. While buyout activity slowed considerably, rising commodity prices, particularly oil, drove returns in real assets.

Northwestern's investment assets continued to grow in spite of the global financial credit crisis and economic malaise. The University's assets grew as a result of its selling a portion of its royalty interest in the pain relief drug Lyrica®, which was developed in University laboratories, and investing the net proceeds in the Long-Term Balanced Pool. When the fiscal year ended on August 31, 2008, the University's investment assets totaled $7.18 billion, including cash and intra-University investments, an increase of $593 million from August 31, 2007. It was the fifth year in a row of asset growth of more than $500 million.

The University's Total Investment Pools

The University maintains three primary investment vehicles: The Long-Term Balanced Pool, treasury funds, and separately invested assets. Each investment category has a specific set of objectives.

The Long-Term Balanced Pool, the primary fund, is managed with the objective of long-term total return. Because of its size and long-term orientation, performance data and investment strategy information in the discussion that follows relate to the Long-Term Balanced Pool.

Treasury funds are money market funds used for cash reserves and to preserve principal and maintain liquidity; intermediate-term bond investments; and working capital funds held by the University, which are generated through the temporary differences between operating receipts and disbursements. These funds are not unitized. The income from investing them is used for general operating purposes. Working capital investments are held in a variety of money market instruments and guaranteed student loans or, if not needed within 90 days, are invested in the Long-Term Balanced Pool.

Separately invested funds are donated funds, including restricted investments and some life-income plans.

The table below illustrates the net asset values and unitized information for the University's investment pools for the past five years.

History of the Merged Pools as of August 31

	2004	*2005*	*2006*	*2007*	*2008*
Long-Term Balanced Pool					
Net asset value (in thousands of dollars)	$3,668,410	$4,374,206	$5,190,425	$6,380,194	$6,942,081
Number of units (in thousands)	23,765	24,704	26,519	27,753	31,378
Net asset value per unit	$154.36	$177.06	$195.73	$229.89	$221.24
Payout amount per unit					
Current earned income	$1.46	$2.73	$1.96	$3.25	$0.65
Previously reinvested realized gains withdrawn	$5.41	$4.02	$4.85	$3.97	$8.45
Total payout per unit	$6.87	$6.75	$6.81	$7.22	$7.80
Summary of net asset values (in thousands of dollars)					
Treasury pool funds	$294,391	$174,755	$61,217	$84,430	$87,819
Separately invested funds	103,922	106,760	78,471	123,648	$151,169
Total net asset value (in thousands of dollars)	**$4,066,723**	**$4,655,721**	**$5,330,113**	**$6,588,272**	**$7,181,069**

Asset Allocation for the Long-Term Balanced Pool

The Investment Committee of the University annually reviews asset allocation policy for the Long-Term Balanced Pool. In fiscal year 2008, the committee implemented modest changes to the allocation targets based on the Investment Office's optimization modeling of a more efficient portfolio that should generate higher returns with lower risk levels. The target allocations for U.S. equities and international equities were decreased 3 percent and 1 percent, respectively. The target allocation for private investments was increased 4 percent. The total allocation to both public and private equity remained unchanged at 50 percent. The next chart displays the current asset allocation policy for the University; actual allocations vary from targeted levels by modest amounts, reflecting the Investment Office's bias against market timing or tactical asset allocation as a primary driver of value added.

Policy Portfolio Targets and Ranges				
	Range	*Target*	*August 31, 2008*	*Difference*
U.S. equity securities	11–17%	14%	14.5%	0.5%
International equity securities	13–19%	16%	12.6%	-3.4%
Fixed-income securities	7–13%	10%	10.1%	0.1%
High-yield credit	2–8%	5%	7%	2%
Absolute return	14–22%	18%	17.3%	-0.7%
Private investments	16–24%	20%	20.8%	0.8%
Real assets	13–21%	17%	18.8%	1.8%
Cash		0%	-1.1%	-1.1%

Primary Investment Performance Objective: Preserving Purchasing Power and Growing Income

The principal objective for Northwestern's Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. On average, the pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies. A more detailed look at the University's spending guideline is on page 11 of this report.

The University's investments historically have grown at a rate exceeding the objective. As of August 31, 2008, the Long-Term Balanced Pool's assets were $6.94 billion, up approximately $562 million from last year. For the 12-month period ending August 31, 2008, the portfolio increased 0.33 percent, which was 8.44 percent below the objective. For the 3-, 5-, 10-, and 15-year periods ending August 31, 2008, the objective was exceeded by 5.09 percent, 7.19 percent, 4.85 percent, and 4.5 percent, respectively.

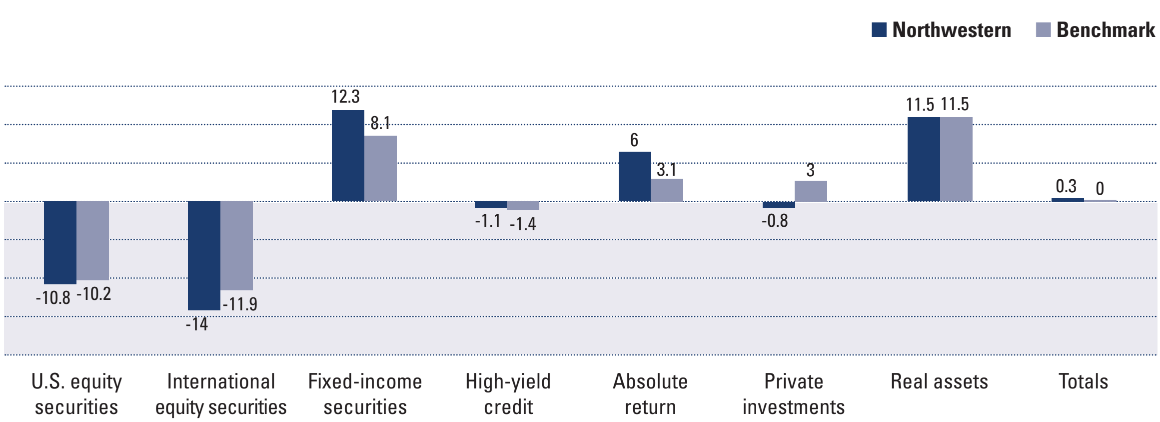
Annualized Returns: Exceeding the Objective					
	1-year	**3-year**	**5-year**	**10-year**	**15-year**
*Annual total return**	0.33%	12.25%	14.45%	11.51%	10.95%
– Spending	3.40%	3.44%	3.77%	3.82%	3.75%
– Inflation	5.37%	3.71%	3.49%	2.84%	2.71%
= Above or below objective	**-8.44%**	**5.10%**	**7.19%**	**4.85%**	**4.49%**

**Total returns are net of fees and are calculated on annual changes in net asset value. They may differ from payout distributions.*

Secondary Investment Performance Objective: Benchmark Comparisons

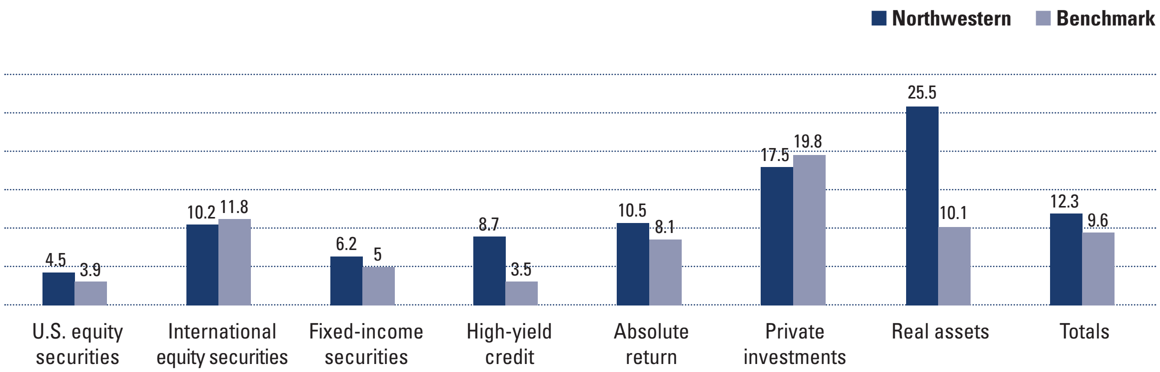
The pool's 0.33 percent gain for the 12-month period exceeded the 0 percent return of the composite benchmark, a blend of the benchmark returns for each asset class weighted by the policy allocation targets. Outperformance resulted primarily from the strong performance of the fixed income and absolute return portfolios relative to their respective benchmarks. Private investments and equities were weak in both absolute and relative terms. The real assets category produced strong absolute performance in line with its benchmark. The following chart shows returns and benchmarks for all asset classes for the fiscal year. A more detailed explanation of activity and performance follows the three-year performance chart below.

Long-Term Balanced Pool: Fiscal 2008 Net Performance Relative to Benchmarks (in percentages)



For the three-year period ended August 31, 2008, the pool also outperformed the composite benchmark (12.3 percent versus 9.6 percent), as shown in the next chart. Five of the seven categories exceeded their benchmarks over three years.

Long-Term Balanced Pool: Three-Year Net Performance Relative to Benchmarks (in percentages)



Marketable Securities Categories

The domestic equity portfolio fell 10.8 percent for the fiscal year, underperforming the 10.2 percent decline of the benchmark Russell 3000. However, the move from passive to active management has paid off; this portfolio has outperformed its benchmark by 60 basis points (4.5 percent versus 3.9 percent) over the three-year period since an active program began.

The fiscal-year performance for the international equity portfolio — a 14 percent loss — was weak in absolute terms. In relative terms the portfolio lagged the benchmark by 2.1 percent. Even though it returned 10.2 percent for the last three years, the international portfolio trailed the benchmark by 1.6 percent annualized, partly due to investment manager underperformance.

As investors fled to quality amid the credit contraction, bonds were the best performing asset class during the fiscal year in both absolute and relative terms. They gained 12.3 percent, compared with 8.1 percent for the Lehman Government Index. Global bonds and portable alpha fixed-income strategies provided significant alpha (the return for an asset class in excess of the corresponding benchmark), and the bond portfolio also outperformed the index for the three-year period by 120 basis points (6.2 percent versus 5 percent).

High-Yield Credit

The high-yield credit portfolio includes investments in distressed debt, emerging market debt, and other credit instruments with fixed-income characteristics but more specific risk tied to the securities and their underlying cash flows. The portfolio declined 1.1 percent during the fiscal year, outpacing the 1.4 percent of the benchmark Merrill Lynch High-Yield Master II Index. Returns from distressed managers, high-yield hedge funds, and emerging market debt investments led to a smaller decline for this asset class relative to the benchmark

Absolute-Return Category

Made up of 24 different hedge funds, this portfolio aims to provide equity-like returns with low correlation to the equity markets. For the year, it gained 6 percent, beating the 3.1 percent return of its benchmark (80 percent, Treasury bills plus 400 basis points; 20 percent, Morgan Stanley Capital International All-Country World Index). Northwestern's absolute-return portfolio is weighted toward long-short equity managers (60 percent). The remaining hedge funds (40 percent) are more market neutral or represent diversifying strategies.

Private Investments Category

The private investments portfolio includes investments in global buyout funds as well as venture capital. In fiscal year 2008 this portfolio lost 0.8 percent, compared with the Cambridge Associates' universe pooled mean return of private investments' 3 percent. Decreased merger and acquisition activity, lower stock markets, and receding economies worldwide contributed to a negative environment for these investments.

Net cash flows weakened and turned negative during the latter part of the fiscal year. The portfolio experienced a significant decline in trade sales, recapitalizations, and initial public offerings, resulting in fewer distributions from the portfolio companies. Private investment distributions were $231.8 million for fiscal year 2008, compared with $355.5 million the previous year. The University's manager relationships and reputation in the marketplace remain strong.

Real Assets Category

The real assets portfolio includes the University's investments in energy, timber, real estate, and other commodities. This portfolio had strong results in fiscal year 2008, gaining 11.5 percent. Realizations in private partnership energy investments and increased global demand for commodities and energy-related substances contributed to the returns. These factors resulted in cash distributions of $180.3 million from energy and real estate partnerships.

Long-Term Balanced Pool Spending Guideline

After the University's Investment and Budget Committees reviewed the Long-Term Balanced Pool's spending guideline, the Board of Trustees in fiscal year 2006 ratified a revised spending guideline blending two elements:

- *Market element* adjusts annual endowment spending to the long-term sustainable target spending of 4.35 percent of the average actual market value of the endowment for the 12 months ending the October following the latest fiscal year. This component of the spending rate receives a 30 percent weighting in the spending rate calculation.
- *Spending element* increases the previous year's spending rate by actual inflation plus budget growth (1.5 percent). This element of the spending rate receives a weight of 70 percent.

The actual spending rate per unit for fiscal year 2008 was $7.80; it will be $8.54 for fiscal year 2009. The payout rate for fiscal year 2008 was 3.35 percent.

Payout Determined by Spending Guideline

	2004	*2005*	*2006*	*2007*	*2008*
Spending per unit	$6.87	$6.75	$6.81	$7.22	$7.80
Net asset value per unit	$154.36	$177.06	$195.73	$229.89	$221.24
Payout rate*	4.46%	3.91%	3.53%	3.28%	3.35%
Total (in millions)	$160.44	$161.44	$176.21	$197.50	$233.50
Growth in total spending	6.47%	0.62%	9.15%	12.08%	18.23%

*Payout rate is calculated as spending per unit divided by the two-year average net asset value per unit before distribution of the annual contribution to the budget.

The Long-Term Balanced Pool: In Conclusion

The diversification of the Long-Term Balanced Pool positions it to meet investment objectives over long time horizons. The Investment Office believes that long-term prospects for growth in worldwide financial markets are being masked by turmoil, fear, and uncertainty, and that the pool has many opportunities in that environment.

Securities Lending

Northwestern initiated a securities lending program with its bank custodian, Northern Trust, in 2003. The agreement allowed the investment custodian to lend University securities to approved brokers in exchange for a fee. The University terminated the agreement with the investment custodian in April 2008 and suspended the securities lending program indefinitely. No investment securities were outstanding on loan at fiscal year-end.

William H. McLean
Vice President and Chief Investment Officer

Independent Auditors' Report

To the Board of Trustees of Northwestern University:

We have audited the accompanying consolidated statements of financial position of Northwestern University and subsidiaries (the "University") as of August 31, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University as of August 31, 2008 and 2007, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Chicago, Illinois

January 22, 2009

Consolidated Statements of Financial Position

As of August 31, 2008, and August 31, 2007

(in thousands of dollars)	*2008*	*2007*
Assets		
Cash and cash equivalents	$157,772	$184,592
Accounts receivable	269,462	232,939
Notes receivable	87,488	54,741
Contributions receivable	116,698	105,343
Collateral held for securities loaned	—	470,720
Investments	7,135,378	6,496,665
Land, buildings, and equipment	1,349,548	1,250,093
Bond proceeds held by trustees	118,537	81,136
Other assets	61,287	63,648
Total assets	**$9,296,170**	**$8,939,877**
Liabilities		
Accounts payable and accrued expenses	$223,333	$146,227
Deferred revenue	261,384	244,689
Payable under securities loan agreements	—	470,720
Actuarial liability of annuities payable and deposits payable	65,868	64,870
Reserves for self-insurance	47,675	51,586
Government advances for student loans	38,936	39,084
Asset retirement obligations	104,533	108,926
Bonds and notes payable	813,824	610,883
Total liabilities	**$1,555,553**	**$1,736,985**
Net assets		
Unrestricted	$6,675,447	$6,182,157
Temporarily restricted	130,814	149,139
Permanently restricted	934,356	871,596
Total net assets	**$7,740,617**	**$7,202,892**
Total liabilities and net assets	**$9,296,170**	**$8,939,877**

Detail of net assets	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	*2008*
Operating funds	$747,118	$88,400		$835,518
Invested in plant facilities	1,288,195	12,882		1,301,077
Annuity and life income funds	17,718	10,238	$47,733	75,689
Endowment and similar funds	4,622,416	19,294	886,623	5,528,333
Total net assets	**$6,675,447**	**$130,814**	**$934,356**	**$7,740,617**

Detail of net assets	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	*2007*
Operating funds	$689,342	$94,793		$784,135
Invested in plant facilities	1,131,879	16,208		1,148,087
Annuity and life income funds	21,683	16,073	$36,642	74,398
Endowment and similar funds	4,339,253	22,065	834,954	5,196,272
Total net assets	**$6,182,157**	**$149,139**	**$871,596**	**$7,202,892**

See Notes to the Consolidated Financial Statements, beginning on page 16.

Consolidated Statements of Activities

For the fiscal years ended August 31, 2008, and August 31, 2007

(in thousands of dollars)	*2008*		*2007*	
Changes in unrestricted net assets				
Operating revenues				
Tuition and fees	$655,369		$611,189	
(less scholarships and fellowships)	(195,624)		(182,136)	
Net tuition and fees	459,745		429,053	
Auxiliary services	67,115		66,524	
Grants and contracts	378,172		367,338	
Private gifts	120,577		77,611	
Investment return designated for operations	306,344		258,111	
Professional fees	29,558		31,986	
Sales and services	127,987		123,981	
Royalties and trademarks	782,746		93,606	
Other income	48,039		10,793	
Total operating revenues		**$2,320,283**		**$1,459,003**
Operating expenses				
Instruction	544,018		502,585	
Research	339,596		321,949	
Academic support	169,360		157,691	
Student services	109,045		103,906	
Institutional support	294,716		158,050	
Auxiliary services	106,300		107,383	
Total operating expenses		**1,563,035**		**1,351,564**
Excess of operating revenues over expenses		**757,248**		**107,439**
Nonoperating				
Private gifts and grants for buildings and equipment	9,586		14,277	
Investment (losses uninvested) and gains reinvested	(324,916)		997,366	
Loss on defeasance of bonds payable	—		(4,995)	
Change in unrestricted net assets from nonoperating activities		**(315,330)**		**1,006,648**
Net assets released from restrictions		**51,372**		**50,702**
Change in unrestricted net assets		**493,290**		**1,164,789**
Changes in temporarily restricted net assets				
Private gifts	30,928		67,896	
Net losses on annuity obligation	(1,222)		(892)	
Investment returns	3,341	33,047	3,475	70,479
Net assets released from restrictions		**(51,372)**		**(50,702)**
Change in temporarily restricted net assets		**(18,325)**		**19,777**
Changes in permanently restricted net assets				
Private gifts	52,544		47,916	
Net gain on annuity obligation	10,216	62,760	1,635	49,551
Change in permanently restricted net assets		**62,760**		**49,551**
Change in net assets		**537,725**		**1,234,117**
Beginning net assets		**$7,202,892**		**$5,968,775**
Ending net assets		**$7,740,617**		**$7,202,892**

See Notes to the Consolidated Financial Statements, beginning on page 16.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2008, and August 31, 2007

(in thousands of dollars)	*2008*	*2007*
Cash flows from operating activities		
Change in net assets	**$537,725**	**$1,234,117**
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	87,858	76,643
Accretion for asset retirement obligations	5,083	5,330
Reduction in asset retirement obligations	(9,476)	—
(Gain) loss on retirement of building and equipment	(7,260)	1,534
Gain on sale of land and building	(31,529)	—
Amortization of discount on bonds payable	73	73
Accretion of premium on bonds payable	(152)	(152)
Net realized and unrealized losses (gains) on investments	68,434	(1,100,339)
Private gifts and grants for long-term investments	(9,586)	(14,277)
Changes in assets and liabilities		
Accounts receivable	(39,574)	(3,053)
Contributions receivable	(11,355)	(9,038)
Other assets	2,361	(21,346)
Accounts payable and accrued expenses	75,503	23,215
Deferred revenue	16,695	8,165
Reserves for self-insurance	(3,911)	(13,945)
Government advances for student loans	(148)	(269)
Net cash provided by operating activities	**680,741**	**186,658**
Cash flows from (used in) investing activities		
Purchases of investments	(2,829,458)	(2,526,922)
Proceeds from sales of investments	2,124,887	2,407,758
Decrease (increase) in trusts held by others	3,051	(5,412)
Increase in investments held for others	(2,576)	(4,450)
Acquisitions of land, buildings, and equipment	(185,441)	(127,459)
Proceeds from sale of plant assets	38,520	—
Student loans disbursed	(74,816)	(99,331)
Principal collected on student loans	42,069	92,734
Net cash used in investing activities	**(883,764)**	**(263,082)**
Cash flows from (used in) financing activities		
Net proceeds from issuance of notes payable and bonds payable	205,500	25,241
Principal payments on notes payable and bonds payable	(2,480)	(2,390)
(Increase) decrease in bond proceeds held by trustees	(37,401)	27,750
Proceeds from private gifts and grants for long-term investments	9,586	14,277
Decrease in annuities payable and deposits payable	998	18,550
Net cash provided by financing activities	**176,203**	**83,428**
(Decrease) increase in cash and cash equivalents	**(26,820)**	**7,004**
Cash and cash equivalents at beginning of year	**184,592**	**177,588**
Cash and cash equivalents at end of year	**$157,772**	**$184,592**
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	$19,449	$17,846
Capitalized interest	2,694	1,128
Cash paid for interest	22,592	23,294
Defeasance of bonds payable	—	145,000

See Notes to the Consolidated Financial Statements, beginning on page 16.

1. Summary of Significant Accounting Policies

University Activities
Northwestern University (the University) is a major private research university with more than 17,000 students enrolled in 11 academic divisions on two lakefront campuses in Evanston and Chicago and an international campus in Doha, Qatar, that was established in fiscal year 2008. Northwestern University in Qatar began classes in August 2008 with 39 undergraduate students in journalism and communication.

Northwestern's mission is to provide the highest-quality education for its students, to develop innovative programs in research, and to sustain an academic community that embraces these enterprises. Activities supporting its mission may be classified as either operating or nonoperating.

Basis of Accounting

General
The University maintains its accounts and prepares its consolidated financial statements on the accrual basis of accounting in conformity with generally accepted accounting principles in the United States of America (GAAP). These statements include all wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Contributions
The University prepares its financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made." SFAS No. 116 requires that contributions received, including unconditional promises to give (pledges), be recognized as revenues at their fair values. Private gifts, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not included in revenue until the conditions are substantially met. Pledges receivable due in more than one year are recorded at the present value of the estimated future cash flows.

Net Asset Classifications
SFAS No. 117, "Financial Statements of Not-for-Profit Organizations," establishes standards for external financial reporting by not-for-profit organizations and requires that net assets and the flow of those assets be classified in three net asset categories according to the existence or absence of donor-imposed restrictions.

The category *Unrestricted Net Assets* describes funds that are legally available for any purpose and have no donor-imposed restrictions. All revenues, expenses, gains, and losses are classified as unrestricted net assets unless they are changes in temporarily or permanently restricted net assets.

The category *Temporarily Restricted Net Assets* includes gifts for which donor-imposed restrictions have not been met (these are primarily future capital projects) and trust activity and pledges receivable whose ultimate use is not permanently restricted.

The category *Permanently Restricted Net Assets* applies to gifts, trusts, and pledges whose donors required that the principal be held in perpetuity and that only the income be available for stipulated program operations.

Income from temporarily restricted sources is reclassified as unrestricted income when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as unrestricted income. The expiration of a donor-imposed restriction on a contribution is recognized in the period in which the restriction expires. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donor's stipulations causes the release of the restriction.

Cash and Cash Equivalents
Cash reflects currency and deposits or other accounts with financial institutions that may be deposited or withdrawn without restriction or penalty. *Cash equivalents* represent short-term and highly liquid investments that convert readily to cash and carry little risk of change in value at maturity due to interest rate changes.

Investments
Investments are recorded at fair value, determined on the following basis:

- Equity securities with readily determinable fair values and debt securities are valued at the last sale price (if quotations are readily available) or at the closing bid price in the principal market in which such securities are normally traded (if no sale price is available). Certain fixed-income securities are valued based on dealer-supplied valuations.

• The estimated fair values of equity securities that do not have readily determined fair values, and of other investments, are based on estimates provided by external investment managers and are examined through a valuation review process performed by management. After this review, management may determine that an adjustment to the external managers' valuations is appropriate in recording the securities' fair value at August 31. The aggregate carrying value of these securities included within fixed income, high-yield credit, absolute return, private investments, and real assets was $4,380.6 million (47.1 percent of total assets) and $3,725.5 million (41.7 percent of total assets) at August 31, 2008, and 2007, respectively. These investments are generally less liquid than other investments.

During the examination process management reviewed the valuation policies for all partnerships in which Northwestern University is invested and deemed those policies appropriate. In addition to receiving the most recent available audited and unaudited financial statements from the external managers, management contacted the majority of general partners regarding the aggregate carrying value of the respective investments at August 31, 2008.

A range of possible values exists for these partnership investments, and therefore the estimated values may be materially different from the values that would have been used had a ready market for these partnerships existed. In the absence of another basis, management has determined that cost represents an approximation of the fair value of such investments. A small number of investments within certain partnerships may have holdings at a carrying value of cost, and management has determined this to be appropriate for these specific investments.

Investment income is recorded on the accrual basis, and purchases and sales of investment securities are reflected on a trade-date basis.

Derivative Financial Instruments

The University uses various financial instruments to hedge the risk of decline in fair value of certain equity securities. Equity options and equity-indexed options are used to reduce the primary market risk exposure (e.g., equity price risk) of the hedged item in conjunction with the specific hedged strategy; if applicable, these have a reference index (e.g., S&P 500) that is the same, or highly correlated with, the reference index of the hedged item. In addition, the University uses various financial instruments to hedge foreign currency liabilities. Similarly, the University also enters into swap agreements to hedge public real estate equity exposure and obtain S&P 500 equity index exposure, and it uses futures contracts on equity and bond indices. Such instruments are not designated as hedges for accounting purposes and are recorded at fair value.

In fiscal year 2008, the University entered into a euro-dominated foreign currency swap as a hedge against a portion of future capital commitments to foreign currencies. The University also added various interest rate options to hedge the overall portfolio and used an interest rate swap agreement to hedge variable interest rate exposure. In fiscal year 2007, the University entered into a credit hedge transaction involving put options on the S&P 500 index and used an interest rate swap agreement to hedge variable interest rate exposure. The credit hedge and put options were liquidated in 2008.

Fair Values of Financial Instruments Other than Investments

The fair values of financial instruments other than investments are based on a variety of factors. In some cases, fair values represent quoted market prices for identical or comparable instruments. In other cases, fair values have been estimated based on assumptions about the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of risk. Accordingly, the fair values may not represent actual values that could have been realized at year-end or that will be realized in the future. At August 31, 2008, the fair value of the University's fixed rate debt of $351.7 million exceeded the carrying value of $348.2 million by $3.5 million. At August 31, 2007, the fair value of the University's fixed rate debt of $354.6 million exceeded the carrying value of $350.6 million by $4 million.

Accounts and Notes Receivable

Student accounts receivable arising from tuition and fees are carried net of an allowance for doubtful accounts of $475,000 and $503,000 as of August 31, 2008, and 2007, respectively. Notes receivable resulting from student loans are carried net of an allowance for doubtful accounts of $1,256,000 and $417,000 as of August 31, 2008, and 2007, respectively.

Receivables from Northwestern Medical Faculty Foundation, a related party (see page 19), arose out of operational activities. They totaled $18.9 million and $21.1 million as of August 31, 2008, and 2007, respectively.

Contributions Receivable

Contributions receivable arising from unconditional promises to give are carried net of an allowance for uncollectible pledges that totaled $17.9 million and $12.6 million at August 31, 2008, and 2007, respectively. Additionally, unconditional promises expected to be collected in periods from more than one year are discounted to present value. The discount rates for pledges made in fiscal years 2008 and 2007 were 3.6 and 4.5 percent, respectively; the discount rate for pledges made in fiscal year 2006 was 4.7 percent; and the discount rate used on all pledges receivable prior to September 1, 2006, was 6.5 percent. Significant conditional promises to give totaled $25.8 million at August 31, 2008, and 2007.

Land, Buildings, and Equipment

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair market value at the date of the gift. Significant renewals and replacements are capitalized. The cost of repairs and maintenance is expensed as incurred. Purchases of library books are also expensed.

Depreciation is calculated using the straight-line method over the useful lives of the buildings and equipment, which are estimated to be 3 to 20 years for equipment and a maximum of 40 years for buildings. The University follows SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The provisions under this statement include a requirement that long-lived assets be reviewed for impairment by comparing the future cash flows expected from the asset to the carrying value of the asset. If the carrying value of an asset exceeds the sum of estimated undiscounted future cash flows, an impairment loss is recognized for the difference between estimated fair value and carrying value. In management's opinion, no impairment existed as of August 31, 2008.

Charitable Remainder Trusts

Charitable remainder trusts are classified as permanently restricted net assets if, upon termination of the trust, the donor permanently restricts the remaining trust assets. If the remainder is temporarily restricted or unrestricted by the donor, the charitable remainder trust assets are recorded as temporarily restricted net assets.

Annuities Payable

Annuities payable consist of annuity payments currently due and the actuarial amount of annuities payable. The actuarial amount of annuities payable is the present value of the aggregate liability for annuity payments over the expected lives of the beneficiaries (based on the 90CM mortality tables in the Internal Revenue Code, Publication 1458, July 1999, and Publication 939, April 2003).

Self-Insurance Reserves

The University maintains a self-insurance program for general liability, professional liability, and certain employee and student insurance coverages. This program is supplemented with commercial excess insurance above the University's self-insurance retention.

Asset Retirement Obligations

The University follows the Financial Accounting Standards Board (FASB) Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—An Interpretation of FASB Statement No. 143" (FIN 47). FIN 47 clarifies the term *conditional asset retirement obligation* as it is used in SFAS No. 143, "Accounting for Asset Retirement Obligations," and requires a liability to be recorded if the fair value of the obligation to retire an asset can be reasonably estimated. Asset retirement obligations covered by FIN 47 include those for which an entity has a legal obligation to perform an asset retirement activity; however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. In accordance with FIN 47, the University records all known asset retirement obligations for which the fair value of the liability can be reasonably estimated, including certain obligations relating to regulatory remediation.

Revenue Recognition

Revenues from tuition and fees are reported in the fiscal year in which educational programs are predominantly conducted. Fiscal year 2009 fall-quarter tuition and fees, billed in fiscal year 2008, are reported as deferred revenue in fiscal year 2008. Similarly, fiscal year 2008 fall-quarter tuition and fees, billed in fiscal year 2007, are reported as deferred revenue in fiscal year 2007.

Revenues from auxiliary services, such as residence and food services, represent fees for goods and services furnished to University students, faculty, and staff; these revenues are recognized in the fiscal year in which the goods and services are provided. Grants and contracts revenue is recognized as expenses are incurred on a project. Professional fees arise from faculty and department services provided to external institutions such as hospitals. Sales and services revenues represent fees for services and goods provided to external parties in the course of educational activities and also include revenues from the provision of physical plant services and goods to external institutions contiguous to the University campuses. Trademark and royalty revenues arise from licensing of innovative technologies, copyrights, and other intellectual property; these revenues are recognized in the fiscal year in which they are earned. Other income includes revenues not otherwise categorized, such as rental revenues from property not held for investment, reimbursements for goods and services, and sundry payments to the University; these revenues are also recognized in the fiscal year in which they are earned.

Income Taxes

The Internal Revenue Service has determined that the University is exempt from income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code, except with regard to unrelated business income, which is taxed at corporate income tax rates. The University files U.S. federal and various state and local tax returns. The statute of limitations on the University's U.S. federal tax returns remains open for fiscal years 2005 through 2008.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," that clarifies accounting for uncertainty in income taxes reported in the financial statements. The interpretation provides criteria for assessment of individual tax positions and a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the "more likely than not" standard for sustainability on examination by tax authorities. FIN 48 was adopted by the University for fiscal year 2008, and there is no material impact on the University's consolidated financial statements.

Related Parties

Northwestern Medical Faculty Foundation (NMFF) is a multispecialty physician organization committed to providing clinical care to patients and to supporting the research and academic endeavors of Northwestern's Feinberg School of Medicine. An independent not-for-profit organization, NMFF is governed by a board of directors. NMFF physicians are full-time faculty members or researchers at Feinberg and attending physicians at Northwestern Memorial Hospital. Under the terms of an agreement with Northwestern University, NMFF contributes a percentage of its revenue to a research and education fund, medical education programs, basic and applied biomedical research facilities and programs, and research and educational support services. NMFF also contributes funds to Feinberg's teaching and research activities on a discretionary basis. These contributions totaled $25 million in fiscal year 2008 and $28.7 million in fiscal year 2007.

Uses of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the relevant period. Actual results could differ from those estimates.

At August 31, 2008, and 2007, reserves were established for uncollectible accounts, student loans, and pledges receivable. These reserves were estimated based on historical collection and allowance practices as well as on management's evaluation of current trends.

The reserves for self-insurance and postretirement medical and life insurance benefits were based on actuarial studies and management estimates.

The reserves for asset retirement obligations were based on analyses of University assets, review of applicable regulatory and other guidance, and management estimates.

The University believes that the methods and assumptions used in computing these reserves and liabilities are appropriate.

Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurements." SFAS No. 157 redefines fair value, provides a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It is effective in fiscal year 2009 for the University.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115." The statement provides the option to report selected financial assets at fair value; it also includes presentation and disclosure requirements to facilitate comparisons between entities using different measurement attributes for similar kinds of assets and liabilities. SFAS No. 159 is effective in fiscal year 2009 for the University.

In March 2008, the FASB issued Statement of Financial Accounting No. 161, "Disclosures about Derivative Instruments and Hedging Activities." The statement is intended to improve financial reporting by requiring enhanced disclosures concerning the effects of derivative instruments and hedging activities on an entity's financial position, financial performance, and cash flows. SFAS No. 161 will be effective in fiscal year 2010 for the University.

In August 2008, the FASB issued Staff Position No. 117-1, "Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and Enhanced Disclosures for all Endowment Funds." It provides guidance about classifying donor-restricted endowment funds and is also expected to improve disclosures about both donor-restricted and board-designated endowment funds regardless of whether the organization is subject to UPMIFA. It is effective in fiscal year 2009 for the University.

The University is evaluating the impact of implementation of these pronouncements on the consolidated financial statements.

2. Bonds and Notes Payable

Bonds and notes payable are as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Demand revenue bonds		
IEFA–Series 1993	$18,015	$20,495
Less unamortized discount on IEFA–Series 1993	(438)	(511)
IEFA–Series 2003	185,010	185,010
IFA–Series 2004	135,800	135,800
IFA–Series 2006	145,130	145,130
Plus unaccreted premium on IFA–Series 2006	5,307	5,459
IFA–Series 2008	125,000	—
Bonds payable subtotal	613,824	491,383
Commercial paper, taxable	200,000	119,500
Notes payable subtotal	200,000	119,500
Total bonds and notes payable	**$813,824**	**$610,883**

Bond issuance	**Interest rate mode**	**Interest rate**	**Maturity**
IEFA–Series 1993	Fixed	5.51%*	December 1, 2008, to December 1, 2013
IEFA–Series 2003	Fixed	5%*	December 1, 2014, to December 1, 2038
IFA–Series 2004	Variable, weekly rate	1.8% and 1.7%+	December 1, 2034
IFA–Series 2006	Fixed	5%*	December 1, 2042
IFA–Series 2008	Variable, weekly rate	1.75%, 1.9%, and 1.7%+	December 1, 2046
Commercial paper, taxable	Fixed	2.4%*	September 13, 2008, to October 1, 2008

** Weighted average interest rate at August 31, 2008 + Weekly variable rate at August 31, 2008*

Total obligations including commercial paper at August 31, 2008, are scheduled to mature through August 31 of each period as noted below. The schedule has been prepared based on the contractual maturities of the debt outstanding at August 31, 2008. Accordingly, if remarketing of bonds fails in future periods, debt repayments may become more accelerated than presented below.

(in thousands of dollars)	
2009	$202,659
2010	2,754
2011	2,954
2012	3,149
2013	3,344
2014–2018	19,700
2019–2023	20,303
2024–2028	758
2029–2033	758
Thereafter	557,445
Total	**$813,824**

Bonds Payable

The IEFA–Series 1993 Revenue Refunding Bonds operate in a fixed mode until maturity, bearing interest at fixed rates ranging from 3 percent to 5.55 percent. Proceeds of the refunding bonds were invested in United States government securities with a cost of $75.4 million and placed in escrow to satisfy scheduled payments of $66.4 million of the IEFA–Series 1985 bonds and related interest until maturity.

The IEFA–Series 2003 Fixed-Rate Revenue Bonds were issued to acquire, construct, or renovate certain University facilities and to refund $35 million of the University's outstanding IEFA–Series 1993 bonds, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Facilities Authority.

The IFA–Series 2004 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects on both the Evanston and the Chicago campuses, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode. In fiscal year 2008, the revenue bonds operated in a weekly rate mode determined by the remarketing agents.

The IFA–Series 2006 Revenue Bonds were issued in October 2006 to refund the University's outstanding IEFA–Series 1997 Adjustable Medium-Term Revenue Bonds totaling $145 million. The refunding bonds are subject to conditions set forth in a trust indenture and loan agreement between the University and the authority.

The IFA–Series 2008 Adjustable Rate Revenue Bonds were issued on June 25, 2008, to acquire, construct, renovate, remodel, improve, and equip capital projects, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode. In fiscal year 2008, the revenue bonds operated in a weekly rate mode determined by the remarketing agents.

Derivative Financial Instruments

On May 17, 2007, the University entered into an interest rate swap agreement to hedge variable interest rate exposure. The agreement, expiring December 1, 2046, effectively fixed the interest rate at 4.14 percent. The notional value was set at $350 million through November 30, 2038, reducing to $200 million effective December 1, 2038, through expiration. At August 31, 2007, the University recognized an unrealized gain on the swap investment totaling $4.2 million.

On May 30, 2008, the University terminated the interest rate swap agreements and executed new interest rate swap agreements to hedge variable interest rate exposure. The University recognized a realized loss on the swap termination totaling $9.1 million. The agreements effectively fix the interest rate from 4.2 percent to 4.38 percent and expire on December 1, 2046. The notional value is $262.1 million through December 1, 2034, and reduces to $125 million effective December 2, 2034, through expiration. At August 31, 2008, the University recognized an unrealized loss on the swap investment totaling $14.5 million.

Notes Payable

The University places commercial paper under a $200 million Taxable Commercial Paper Note. On July 15, 2008, the University renewed two standby letters of credit: $100 million was issued to assure liquidity of short-term debt, and $50 million was issued to provide working capital as needed.

3. Contributions Receivable

Contributions receivable consisted of the following:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Unconditional promises expected to be collected in		
Less than one year	$80,646	$99,993
One year to five years	61,721	24,091
More than five years	—	496
Less discount to present value and other reserves		
Discount to present value	(7,784)	(6,609)
Other reserves	(17,885)	(12,628)
Total	**$116,698**	**$105,343**

4. Investments

The University's investments are overseen by the Investment Committee of the Board of Trustees. Guided by the policies established by the Investment Committee, the University's Investment Office or external equity investment managers, external and internal fixed-income and cash managers, and various limited partnership managers direct the investment of endowment and trust assets, certain working capital, temporarily invested expendable funds, and commercial real estate.

Substantially all of these assets are merged into internally managed investment pools on a market-value basis. Each holder of units in the investment pools subscribes to or disposes of units on the basis of the market value per unit at the beginning of each month.

Endowment Payout/Spending Guideline

The Board of Trustees adopted a revised guideline effective in fiscal year 2007 for the annual spending rate from the Long-Term Balanced Pool. The calculation blends market and spending elements for the total annual spending rate.

The market element is an amount equal to 4.35 percent of the market value of a unit in the pool, averaged for the 12 months ending October 31 of the prior fiscal year. It is weighted at 30 percent in determining the total. The spending element is an amount equal to the current fiscal year's spending amount increased by 1.5 percent, plus the actual rate of inflation. It is weighted at 70 percent in determining the total.

If endowment income received is not sufficient to support the total-return objective, the balance is provided from realized and unrealized gains. If income received is in excess of the objective, the balance is reinvested in the Long-Term Balanced Pool on behalf of the unit holders.

The University's policy is to allocate the current income of all other investment pools.

Investment Market Value

The following charts show the cost and estimated fair value of investments held by the University:

(in thousands of dollars)	*August 31, 2008*		*August 31, 2007*	
	Cost	**Estimated fair value**	**Cost**	**Estimated fair value**
U.S. equity securities	$827,243	$953,953	$745,968	$974,009
International equity securities	933,840	872,147	792,143	979,251
Fixed income securities	770,797	821,982	682,187	703,387
High-yield credit	448,024	494,424	285,386	374,355
Absolute return	751,907	1,216,526	623,561	1,070,442
Private investments	1,582,360	1,460,793	1,335,354	1,320,975
Real assets	962,851	1,245,622	737,270	1,004,482
Other assets	53,287	69,931	50,369	69,764
Total investments	**$6,330,309**	**$7,135,378**	**$5,252,238**	**$6,496,665**

At August 31, 2008, the University was committed to making future capital contributions in other investments in the amount of $1,835 million, primarily in the next five years.

The carrying value of the University's investments (excluding intrauniversity investments, cash, and cash equivalents) is shown by investment pool in the following charts:

(in thousands of dollars)					*August 31, 2008*
	Operations and plant	**Quasi-endowment**	**Annuity and life-income**	**Permanent endowment**	**Total**
Long-Term Balanced Pool	$827,279	$2,399,622		$2,829,084	$6,055,985
Intermediate-Term Bond Pool	811,461	42,124			853,585
Separately invested	92	61,366	$79,610	10,101	151,169
Working capital	74,639				74,639
Total investments	**$1,713,471**	**$2,503,112**	**$79,610**	**$2,839,185**	**$7,135,378**

(in thousands of dollars)					*August 31, 2007*
	Operations and plant	**Quasi-endowment**	**Annuity and life-income**	**Permanent endowment**	**Total**
Long-Term Balanced Pool	$739,655	$1,951,227	$37,882	$2,864,212	$5,592,976
Intermediate-Term Bond Pool	671,542	35,702			707,244
Separately invested	543	57,917	57,888	7,300	123,648
Working capital	72,797				72,797
Total investments	**$1,484,537**	**$2,044,846**	**$95,770**	**$2,871,512**	**$6,496,665**

Investment Return

The components of total investment return were as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Investment income	$56,254	$153,201
Net realized gains	388,026	643,392
Change in net unrealized (losses) gains on investments reported at fair value	(459,511)	462,359
Total investment return	**($15,231)**	**$1,258,952**

Investment return from operations is defined as the investment payout, according to the spending guideline for the Long-Term Balanced Pool and the actual investment income for all other investments. As reflected in the consolidated statements of activities, investment return was as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Changes in unrestricted net assets		
Operating: investment return	$306,344	$258,111
Nonoperating: investment (losses uninvested) and gains reinvested	(324,916)	997,366
Changes in temporarily restricted net assets		
Investment return	3,341	3,475
Total investment return	**($15,231)**	**$1,258,952**

Derivative Financial Instruments

In fiscal year 2008, the University entered into swap agreements to gain equity exposure to a commodity index and various subindices of the S&P 500 index. The notional value of these swaps outstanding at August 31, 2008, was $122.2 million. The swaps had a realized gain of $8.8 million during fiscal year 2008 and an unrealized loss of $6.8 million as of August 31, 2008.

In addition, the University entered into a euro-dominated foreign currency swap during fiscal year 2008 as an economic hedge against a portion of future capital commitments on foreign currencies. The swap had a notional value of $101 million at the trade date and an unrealized gain of $1.6 million at August 31, 2008.

The University also entered into a hedging transaction via S&P 500 index over-the-counter put options and various interest rate options. The net cost of these options was $15.6 million, and they had a realized loss of $1.2 million during fiscal year 2008, and an unrealized loss of $4.6 million as of August 31, 2008. These options had a notional value of $3,000 million at August 31, 2008.

The University bought and sold futures contracts on a domestic equity index during fiscal years 2008 and 2007 and incurred a realized loss of $5.1 million and a realized gain of $3 million, respectively. As of August 31, 2008, the University had 73 September S&P 500 index futures contracts outstanding with an underlying notional value of $24.4 million and an unrealized loss of $1 million.

In addition, the University bought and sold futures contracts on 2-year and 10-year Treasury notes during fiscal years 2008 and 2007 and incurred a realized loss of $82,000 and a realized gain of $253,000, respectively. At August 31, 2008, the University had no 10-year Treasury note contracts outstanding. At August 31, 2007, the University had 250 10-year Treasury note contracts outstanding, with an underlying notional value of $27.3 million.

The University also bought and sold futures contracts on international equity indices during 2008 and 2007 and incurred a realized loss of $5.1 million and a realized gain of $7.1 million, respectively. As of August 31, 2008, the University had 303 Europe, Australia, and Far East (MSCI EAFE) equity index contracts outstanding. The notional value of these swaps was $30.7 million, and they had an unrealized loss of $3.4 million as of August 31, 2008. There were none outstanding at August 31, 2007.

Lastly, in fiscal year 2007, the University entered into a $1,000 million notional value credit hedge transaction. The net realized gain on the entire hedge transaction was $23.2 million, and the final liquidation of this position occurred in June 2008.

Such equity instruments are not designated as hedges for accounting purposes and are recorded at fair value and included in investments on the consolidated statements of financial position.

Credit exposure represents the University's potential loss if all the counterparties fail to perform under the terms of the contracts, and if all collateral, if any, becomes worthless. This exposure is measured by the fair value of the cash collateral held at the counterparties at the reporting date. The University manages its exposure to credit risk by using highly rated counterparties, establishing risk control limits, and obtaining collateral where appropriate. As a result, the University has limited credit risk. To date, the University has not incurred any losses on derivative financial instruments due to counterparty nonperformance.

The University regularly reviews the use of derivative financial instruments by each of the managers of alternative investment funds in which it participates. While these outside managers generally use such instruments for hedging purposes, derivative financial instruments are employed for trading purposes by 35 independent asset managers of the University funds totaling approximately $2,165 million and $1,450 million at August 31, 2008, and 2007, respectively.

Valuation of Permanent Endowment Funds

The University monitors endowment accounts to identify any accounts for which historical cost was more than market value as of August 31, 2008. In 2008, the historical cost for such accounts was approximately $42 million and the market value totals $38.8 million. In fiscal year 2007, market value exceeded historical costs for permanent endowment accounts. Associated unrealized losses are recorded in the unrestricted net assets classification.

5. Retirement Plans

The University maintains two contributory retirement plans for its eligible faculty and staff. The plans offer employees the choice of two investment company options, Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), and the mutual funds offered by Fidelity Investments. The measurement date for plans is August 31. Participating employee and University contributions are immediately vested. The University contributed $38.5 million and $35.9 million to the two plans in 2008 and 2007, respectively. It expects to contribute $47 million to the two plans in 2009.

The University currently sponsors a health care plan permitting retirees to continue participation on a "pay-all" basis. The retiree contribution is based on the average per-capita cost of coverage for the plan's entire group of active employees and retirees rather than the per-capita cost for retirees only. Retirees are also eligible to participate in certain tuition reimbursement plans and may receive a payment for sick days accumulated at retirement. The accrued cost for postemployment benefits was $7.1 million and $6.5 million at August 31, 2008, and 2007, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

In 2007, the University implemented FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans"; the implementation did not affect the University's consolidated financial statements. SFAS No. 158 requires an employer sponsoring one or more single-employer defined benefit plans to recognize an asset or a liability in the statements of financial position for the plans' overfunded or underfunded status. The asset or liability is the difference between the fair value of plan assets and the related benefit obligation, defined as the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for other postretirement benefit plans such as a retiree health care plan. SFAS No. 158 also requires an employer to recognize actuarial gains or losses and prior service costs or credits in the statements of activities that arise during the period but are not components of net periodic benefit cost. In addition, an employer must measure defined benefit plan assets and obligations as of the date of its fiscal year-end and make specified disclosures for the upcoming fiscal year.

The University funds the benefit costs as they are incurred. The accumulated postretirement benefit obligation (APBO) was as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Active employees not yet eligible	$3,245	$3,208
Active employees eligible	4,209	4,060
Retirees	1,996	1,427
Total	**$9,450**	**$8,695**

The following table sets forth the plan's change in benefit obligation:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Benefit obligation at beginning of year	$8,695	$8,678
Service cost (benefits attributed to employee service during the year)	464	479
Interest cost on accumulated postretirement benefit obligation	525	474
Actuarial loss (gain)	218	(499)
Benefits paid	(1,185)	(874)
Contributions from participants	733	437
Benefit obligation at end of year	**$9,450**	**$8,695**

During fiscal year 2009, expected postretirement benefit payments (net of retirees' contributions) are approximately $559,000.

The following table sets forth the change in plan assets:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Fair value of plan assets at beginning of year	$0	$0
Employer contribution	453	436
Benefits paid	(453)	(436)
Fair value of plan assets at end of year	**$0**	**$0**

The accrued benefit cost recognized in the consolidated statements of financial position, which is included in accounts payable and accrued expenses, was $9.5 million and $8.7 million at August 31, 2008, and 2007, respectively.

The components of the net periodic postretirement benefit cost were as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Service cost (benefits attributed to employee service during the year)	$464	$479
Interest cost on accumulated postretirement benefit obligation	525	474
Amortization of prior service cost	89	109
Amortization of unrealized loss (gain)	109	117
Total	**$1,187**	**$1,179**

The following tables present key actuarial assumptions used in determining APBO as of August 31, 2008, and 2007. First, the assumptions used to determine benefit obligations:

	August 31, 2008	*August 31, 2007*
Settlement (discount) rate	7%	6.2%
Weighted average rate of increase in future compensation levels	4%	4%
Current pre-65 health cost trend rate	8%	9%
Current post-64 health cost trend rate	8%	9%
Ultimate health care cost trend rate	5%	5%
Year when trend rate will reach ultimate trend rate	2011	2011

Next, the assumptions used to define net periodic benefit cost:

	August 31, 2008	*August 31, 2007*
Discount rate	6.2%	5.6%
Weighted average rate of increase in future compensation levels	4%	4%
Current pre-65 health cost trend rate	9%	10%
Current post-64 health cost trend rate	9%	10%
Ultimate health care cost trend rate	5%	5%
Year when trend rate will reach ultimate trend rate	2011	2011

A one-percentage-point change in assumed health care cost trend rates would have had these effects in fiscal year 2008:

(in thousands of dollars)	*1% point increase*	*1% point decrease*
Increase (decrease) in total of service and interest cost	$78	($68)
Increase (decrease) in postretirement benefit obligation	562	(501)

Estimated future benefit payments reflecting anticipated service, as appropriate, are expected to be paid as follows:

(in thousands of dollars)	
2010	$603
2011	695
2012	766
2013	838
2014–2018	5,475
Total	**$8,377**

The University offers a deferred compensation plan under Internal Revenue Code 457(b) to a select group of management and highly compensated employees. There is no University contribution related to this deferred compensation plan. The University has recorded both an asset and a liability related to the deferred compensation plan that totaled $16.8 million and $14.2 million in fiscal years 2008 and 2007, respectively; these are included in investments and actuarial liability of annuities payable and deposits payable on the consolidated statements of financial position.

FASB Staff Position SFAS No. 106-2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvements, and Modernization Act of 2003," requires that the University disclose the effects of the act and assess the impact of the Medicare Part D subsidy on the accumulated postretirement benefit obligation and net periodic postretirement benefit cost. Since the University chose not to pursue the subsidy, measures of the APBO or net periodic postretirement benefit cost do not reflect any amount associated with it in 2008 or prior years.

6. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Land	$27,355	$27,355
Construction in progress	114,754	75,479
Buildings and leasehold improvements	1,658,042	1,577,749
Equipment	349,410	291,904
Accumulated depreciation	(800,013)	(722,394)
Total	**$1,349,548**	**$1,250,093**

The estimated cost to complete construction in progress at August 31, 2008, is $456.6 million. Costs included in construction in progress are future leasehold improvements and building and equipment capitalizations. Building costs are funded by loans, gifts (received or pledged), grants, and unrestricted funds.

Under Northwestern's interest capitalization policy, actual interest expense incurred during the period of construction of an asset for University use is capitalized until that asset is substantially completed and ready for use. The capitalized cost is reflected in the total cost of the asset and depreciated over the useful life of the asset. Assets may include buildings and major equipment.

Asset Retirement Obligations

Under FIN 47, the University records all known asset retirement obligations and changes to those obligations. Asset retirement obligations at August 31, 2007, were adjusted during 2008 as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Balance at beginning of year	$108,926	$103,596
Accretion expense	5,083	5,330
Revision in estimated cash flows	(9,476)	—
Balance at end of year	**$104,533**	**$108,926**

At August 31, 2007, the depreciation and accretion expenses were $508,000 and $5.3 million, respectively. At August 31, 2008, they were $431,000 and $5.1 million, respectively.

Lease Obligations

The University is obligated under numerous operating leases to pay base rent through the lease expiration dates. Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2022. Noncancelable real estate lease expenses allocated on a straight-line basis over the term of the leases totaled $6.8 million at August 31, 2008, and $5.9 million at August 31, 2007. The future minimum lease payments under noncancelable operating leases through August 31 of each period are as follows:

(in thousands of dollars)	
2009	$6,589
2010	5,954
2011	5,496
2012	4,987
2013 and thereafter	26,110
Total	**$49,136**

7. Allocation of Expenses

The University allocated depreciation, plant maintenance expenditures, and interest on indebtedness to the various functional expense categories in the consolidated statements of activities for the fiscal years ended August 31, 2008, and 2007. Those expenses have been distributed to the functional areas of the University as follows:

(in thousands of dollars)				*August 31, 2008*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$798	$13,792	$18,115	$3,597
Research	1,219	21,073	27,679	5,497
Academic support	984	17,016	22,350	4,438
Student services	473	8,180	10,744	2,134
Institutional support	337	5,816	7,640	1,517
Auxiliary services	1,272	21,981	28,869	5,733
Total	**$5,083**	**$87,858**	**$115,397**	**$22,916**

(in thousands of dollars)				*August 31, 2007*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$839	$12,068	$21,187	$3,562
Research	1,302	18,724	32,871	5,526
Academic support	1,003	14,421	25,317	4,256
Student services	491	7,061	12,396	2,084
Institutional support	299	4,296	7,542	1,268
Auxiliary services	1,396	20,073	35,238	5,923
Total	**$5,330**	**$76,643**	**$134,551**	**$22,619**

The allocations were based on the functional use of space on the University's campuses.

8. Self-Insurance Reserves and Other Contingencies

Reserves for losses under the University's self-insurance program, aggregating $47.7 million and $51.6 million at August 31, 2008, and 2007, respectively, include reserves for known losses and for losses incurred but not yet reported. A portion of the reserves pertaining to professional liability has been determined on a discounted present-value basis. The discount rate was 7.5 percent in fiscal years 2008 and 2007. Self-insurance reserves are based on estimates of historical loss experience, and while management believes that the reserves are adequate, the ultimate liabilities may be more or less than the amounts provided.

Under an agreement between the University and Northwestern Medical Faculty Foundation, a proportionate share of primary medical professional liability costs that arise out of events prior to November 1, 2004, is borne by NMFF. As of November 1, 2004, NMFF obtained excess medical liability coverage through another institution for all events after October 1, 2002, and reported after November 1, 2004. As of August 31, 2008, and 2007, there were no accounts receivable from NMFF related to professional liability insurance costs.

Under a borrowing agreement with a lending agency in effect through June 30, 2008, the University had authority to borrow monies for the purpose of originating student loans that when fully disbursed may be sold to the lending agency; no monies were advanced in fiscal year 2008. Additionally, the University has contracted to service the loans sold to the lending agency under an agreement in effect through June 30, 2009; these totaled $209.4 million at August 31, 2008.

Service revenues are the excess of the actual interest collected above the agreed-upon warehouse fees on the serviced loans. The University manages the program to break even and generates no servicing assets or liabilities through these activities. The University guarantees these loans against default up to 10 percent of the original domestic loan portfolio and 30 percent of the original international amounts. The maximum future total payments are $24.7 million as of August 31, 2008. At August 31, 2008, and 2007, $315,000 and $514,000, respectively, were reserved in anticipation of future defaults. Notes receivable on the consolidated statements of position are shown net of these reserves in fiscal years 2008 and 2007.

From time to time, various claims and suits generally incidental to the conduct of normal business are pending or may arise against the University. It is the opinion of management of the University, after taking into account insurance coverage, that any losses from the resolution of pending litigation should not have a material effect on the University's financial position or results of operations.

All funds expended in connection with government grants and contracts are subject to audit by government agencies. While any ultimate liability from audits of government grants and contracts by government agencies cannot be determined at present, management believes that it should not have a material effect on the University's financial position or results of operations.

9. Natural Classification of Expenses

Operating expenses incurred in the fiscal years ended August 31, 2008, and 2007, were as follows:

(in thousands of dollars)	*August 31, 2008*	*August 31, 2007*
Salaries, wages, and benefits	$790,421	$719,091
Services and professional fees	217,435	190,709
Supplies	84,676	74,432
Travel and promotion	71,485	65,382
Trademark and royalty fees	142,377	20,861
Other expenses	27,370	62,372
Maintenance, utilities, and equipment	113,414	114,125
Accretion for asset retirement obligations	5,083	5,330
Interest on bond indebtedness	22,916	22,619
Depreciation	87,858	76,643
Total	**$1,563,035**	**$1,351,564**

10. Securities Lending

In 2007, the University had an agreement with its investment custodian to lend University securities to approved brokers in exchange for a fee. In April 2008, this agreement was terminated, and all securities lending activities ceased. Among other provisions that limit the University's risk, the securities lending agreement specified that the custodian was responsible for lending securities and obtaining adequate collateral from the borrower. Collateral was limited to cash, government securities, and irrevocable letters of credit. At August 31, 2007, investment securities with an aggregate market value of $512.3 million and $509.5 million were loaned to various brokers and were returnable on demand. In exchange, the University received cash collateral of $470.7 million and noncash collateral of $52.5 million at August 31, 2007. In accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the cash collateral is shown as both an asset and a liability on the consolidated statements of financial position.

11. Royalty Interest Monetization

On December 18, 2007, under an agreement with Royalty Pharma Finance Trust, the University received proceeds of $700 million on the sale without recourse of a 50 percent interest in its royalty interest in pregabalin (also known as Lyrica®); related fees totaled $7.5 million. Subsequently, in January 2008, the inventors of pregabalin entered into a disbursement agreement with the University for a certain share of the net royalty sales proceeds received by the University from Royalty Pharma; these distributions totaled $115.4 million. The University will continue to distribute royalties to the inventors according to the agreed-upon remaining royalty interest and based on royalties received from ongoing product sales.

12. Subsequent Event (unaudited)

The S&P 500 index was up 0.6 percent for the period June 30 through August 31, 2008. In September, however, a series of national and global financial events materially affected private investments portfolios. After the Lehman Brothers bankruptcy, declared on September 15, and the federal government's $700 billion Troubled Asset Relief Program and funding support of AIG, world markets dropped substantially. The S&P 500 declined 8.9 percent in September. Based on a review by Northwestern management of the majority of the private and real asset market values in the University's portfolio as of September 30, 2008, an unrealized loss in valuation of approximately $112.2 million will be reflected in fiscal year 2009.

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Produced by University Relations. 2-09/1.6M/AE-MG-GD/11317

Cover photograph by Tom Maday. Other photographs by Steve Anzaldi, Bill Arsenault, and Andrew Campbell.

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