UNIVERSITY OF MAINE AT AUGUSTA

Core Financial Ratios and Composite Financial Index

FY06 to FY09
The financial health of the University of Maine at Augusta (UMA) can be evaluated through the use of industry benchmarks and ratios. The following ratios and related benchmarks are derived from *Strategic Financial Analysis for Higher Education*, Sixth Edition published by KPMG; Prager, Sealy & Co., LLC; and Bearing Point. This book is widely used in the higher education industry and the most recent edition includes guidance specifically for public institutions of higher education. Ratios presented for the University of Maine System (UMS) were obtained from the January 5, 2010 *Ratio Analysis* report prepared by KPMG.

The **Primary Reserve Ratio** provides a snapshot of financial strength and flexibility by indicating how long the institution could function using its expendable reserves (both unrestricted and restricted, excluding net assets restricted for capital investments) without relying on additional net assets generated by operations. This ratio is calculated as follows:

\[
\text{Primary Reserve Ratio} = \frac{\text{Expendable Net Assets}}{\text{Total Expenses}}
\]

The benchmark ratio of .40 provides about 5 months (40% of 12 months) of expenses. Although UMA’s ratio has remained relatively consistent over the past four years, it is below the UMS ratio and indicates that UMA’s reserves provide only about 2 months of operating expenses.

Key items that can impact the primary reserve ratio include principal payments on debt, use of unrestricted net assets to fund capital construction projects, operating results (operating revenues – operating expenses + net nonoperating revenues + depreciation), endowment returns, and total operating expenses.
Although the exact impact on this ratio is not readily determinable, it should be noted that on July 1, 2008 expendable net assets of $1.3 million for University College were transferred from the System Office to UMA. High level analysis indicates that the impact of this transfer and the cost of operations for UC had minimal positive impact on UMA’s FY09 primary reserve ratio.

The **Net Operating Revenues Ratio** is a measure of operating results and answers the question, “Do operating results indicate that the University is living within available resources?” Operating results either increase or decrease net assets and, thereby, impact the other three core ratios: Primary Reserve, Return on Net Assets, and Viability. This ratio is calculated as follows:

\[
\text{Net Operating Revenues Ratio} = \left( \frac{\text{Operating Income (Loss)} + \text{Net Non-Operating Revenues}}{\text{Operating Revenues} + \text{Non-Operating Revenues}} \right)
\]

A target of at least 2% to 4% is a goal over an extended time period, although fluctuations from year to year are likely. A key consideration for institutions establishing a benchmark for this ratio would be the anticipated growth in total expenses.

In accordance with generally accepted accounting principles, noncapital state appropriations are classified in the financial statements as a nonoperating revenue. Because of heavy reliance on state appropriations to fund operating costs, UMA and the other universities within the UMS report ‘operating losses’ every year in their financial statements. Consequently, a key line in their financial statements is ‘income (loss) before other changes’ which is the net of the operating loss and net...
nonoperating revenues. In FY08, UMA’s net operating loss exceeded its net nonoperating revenues, resulting in a loss before other changes in net assets, and the low point of -2.0% shown above.

The FY09 ratio of 9.8% is attributable to the one-time transfer of University College’s net assets of $3.3 million from System Wide Services. This transfer is part of UMA’s FY09 nonoperating revenues. Without this transfer, UMA’s FY09 ratio would have been .7%. The increase from the FY08 ratio of -.2% to the adjusted FY09 ratio of .7% is primarily attributable to an increased allocation of the State of Maine noncapital appropriation as a result of UMA assuming operation of University College.

The **Return on Net Assets Ratio** measures asset performance and management. It determines whether an institution is financially better off than in the previous year by measuring total economic return. It is based on the level and change in total net assets. This ratio is calculated as follows:

\[
\text{Return on Net Assets Ratio} = \frac{\text{Change in Net Assets}}{\text{Total Beginning of the Year Net Assets}}
\]

The nominal rate of return is adjusted for inflation (Higher Education Price Index) to arrive at the real rate. Items that may impact this ratio include those that impact the net operating revenues ratio, along with endowment returns, capital appropriations, capital gifts and grants, capital transfers, and endowment gifts.

Over the past four years, UMA’s return on net assets has fluctuated significantly from one year to the next. The high return in FY07 was primarily attributable to capital gifts received for construction of the
Michael Klahr Center. Endowment returns were also high in FY07. Additional gifts for construction of the Michael Klahr Center and State of Maine capital appropriations enabled UMA to recognize a positive nominal rate of return on net assets in FY08. These revenues offset a negative net operating revenues ratio and negative endowment returns experienced in FY08. On July 1, 2008, the net assets of University College were transferred from System Wide Services to UMA, resulting in the high rate of return for FY09. Without this transfer, UMA’s real rate of return for FY09 would have been 3.3%.

The Viability Ratio measures UMA’s expendable resources that are available to cover debt obligations (e.g., capital leases, notes payable, and bonds payable). This ratio is calculated as follows:

\[
\text{Viability Ratio} = \frac{\text{Expendable Net Assets}^*}{\text{Long-Term Debt}}
\]

* Excluding net assets restricted for capital investments

Like the primary reserve ratio, the viability ratio is impacted by such items as principal payments on debt, use of unrestricted net assets to fund capital construction projects, operating results (operating revenues – operating expenses + net nonoperating revenues + depreciation) and endowment returns. Issuance of new debt would also impact the ratio.

A ratio of 1.00 or greater indicates that there are sufficient resources to satisfy debt obligations. UMA’s ratio has surpassed both the UMS ratio and the industry benchmark in each of the past four fiscal years.
The spike in UMA’s ratio in FY09 is attributable to the one-time transfer of University College’s net assets from System Wide Services. Without the transfer, UMA’s FY09 ratio would have been 1.48. UMA has the second lowest level of debt within the UMS.

The **Composite Financial Index (CFI)** creates one overall financial measurement of the institution’s health based on the four core ratios: primary reserve ratio, net operating revenues ratio, return on net assets ratio, and viability ratio. The CFI is calculated by:

- Determining the value of each ratio;
- Converting the value of each ratio to strength factors along a common scale; and
- Strength factors are then multiplied by specific weighting factors; and
- The resulting four numbers are totaled to reach the single CFI score.

These scores do not have absolute precision. They are indicators of ranges of financial health that can be indicators of overall institutional well-being, when combined with nonfinancial indicators. This would be consistent with the fact that there are a large number of variables that can impact an institution and influence the results of these ratios. However, the ranges do have enough precision to be indicators of the institutional financial health, and the CFI as well as its trend line, over a period of time, can be the single most important measure of the financial health for the institution.
A score of 1.0 indicates very little financial health; 3, the low benchmark, represents a relatively stronger financial position; and 10, the top range of the scale. In three of the past four years, UMA's CFI score was above the low industry benchmark and was well above the UMS' score. The spike in FY09 is again attributable to the transfer of University College’s net assets to UMA.

Each ratio’s strength factor and the total CFI score can be evaluated on the following parameters (based on a floating scale):

<table>
<thead>
<tr>
<th>Score</th>
<th>Performance Indication</th>
</tr>
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<tbody>
<tr>
<td>-1 to 1</td>
<td>Assess institutional viability to survive</td>
</tr>
<tr>
<td>0 to 3</td>
<td>Re-engineer the institution</td>
</tr>
<tr>
<td>2 to 5</td>
<td>Direct institutional resources to allow transformation</td>
</tr>
<tr>
<td>4 to 7</td>
<td>Focus resources to compete in future state</td>
</tr>
<tr>
<td>6 to 9</td>
<td>Allow experimentation with new initiatives</td>
</tr>
<tr>
<td>8 to 10</td>
<td>Deploy resources to achieve a robust mission</td>
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</tbody>
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The strength factors for the four core ratios can be mapped on a diamond to show a **Graphic Financial Profile** of UMA’s financial health compared to the industry benchmarks. The charts on the following page graphically display how each of the core ratios relates to one another as part of the CFI. Two institutions could have the same CFI score, yet have very different looking charts depending on the individual ratio results.

The center point of the graphic financial profile is zero. Any value that actually falls below zero defaults to the center of the graph. The maximum value in the graph is 10; thus, any actual values greater than 10 are not plotted beyond the outer diamond. The smaller, heavily lined diamond represents the low industry benchmark of 3. The institution’s ratio values are plotted and shaded to show how the institution’s health compares with the low and high benchmarks. Unless there is an unusual circumstance, an institution would want the plotting of its ratios to at least shade the entire smaller diamond.

As shown in the following charts, UMA’s viability ratio has been strong over the past four years. UMA’s strength in the other three areas has fluctuated as previously discussed.
University of Maine at Augusta  
Core Financial Ratios and Composite Financial Index  
FY06 to FY09

**Graphic Financial Profile - FY06**  
CFI Score of 3.4

<table>
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<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
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<tbody>
<tr>
<td>Primary Reserve Ratio</td>
<td>4.0</td>
<td>5.6</td>
<td>4.0</td>
<td>10.0</td>
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<tr>
<td>Net Operating Revenues Ratio</td>
<td>1.6</td>
<td>1.4</td>
<td>1.4</td>
<td>4.0</td>
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<tr>
<td>Return on Net Assets Ratio</td>
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<td>5.7</td>
<td>0.8</td>
<td>10.0</td>
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<tr>
<td>Viability Ratio</td>
<td></td>
<td></td>
<td>7.5</td>
<td>7.7</td>
</tr>
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**Graphic Financial Profile - FY07**  
CFI Score of 4.3

**Graphic Financial Profile - FY08**  
CFI Score of 2.7

**Graphic Financial Profile - FY09**  
CFI Score of 6.2

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