University of Maine at Fort Kent

Core Financial Ratios and Composite Financial Index
FY06 to FY09
The financial health of the University of Maine at Fort Kent (UMFK) 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 (System) 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. At the highest point in the past four years, UMFK’s reserves provided only about 1 month of expenses. In FY09 the coverage slipped to less than a quarter of a month.

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.
The high ratio in FY07 is attributable to a 53% increase in expendable net assets that resulted from a combination of things, including positive operating results, high endowment returns, and a large capital transfer from the System Office to partially fund interest paid on UMFK’s bonds payable. The ratio fell in FY08 as operating expenses increased 6.8% and operating results and endowment returns were negative. In FY09, the primary reserve ratio reached the lowest point in the past four years as endowment returns were negative and operations generated a loss almost twice as large as the FY08 loss.

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:

\[
\text{Net Operating Revenues Ratio} = \frac{\text{Operating Income (Loss) plus Net Non-Operating Revenues}}{\text{Operating Revenues plus Non-Operating Revenues}}
\]
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.

UMFK’s ratio has been negative for the past four years with the worst ratios being experienced in FY06 and FY09. The ratio improved significantly in FY07 as operating revenues increased 14.5% and nonoperating revenues increased 12.5% compared with an 8.3% increase in operating expenses. Revenues increased again in FY08 but at a much lower percentage than FY07. The increase could not, however, keep pace with the increase in expenses. In FY09, operating revenues fell 5.5% and nonoperating revenues only increased 1.5%. Without the State Fiscal Stabilization Program revenue, FY09 nonoperating revenues would have decreased 3% from the FY08 level.

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. UMFK’s real rate of return has been negative for the past four fiscal years.
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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. The positive nominal rate of return in FY07 is attributable to high market returns on the endowment and a large capital transfer from the System Office. In FY08 and FY09, the net operating revenues ratio fell significantly as previously discussed, endowment returns were negative, and there were no significant capital transfers from the System Office.

The **Viability Ratio** measures UMFK’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:

\[
\text{Expendable Net Assets}^* - \text{Long-Term Debt}
\]

* Excluding net assets restricted for capital investments

![Viability Ratio Chart]

A ratio of 1.00 or greater indicates sufficient resources to satisfy debt obligations. UMFK basically has had no viability over the past four years with ratios close to zero.

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 also impacts the ratio. As previously discussed, expendable net assets increased 53% in FY07 because of positive operating results once depreciation is added back, high endowment
returns, and a large capital transfer from the System Office. The viability ratio decreased in FY08 and FY09 as negative operating results and negative endowment returns caused expendable net assets to decrease at a faster rate than debt was reduced. Another contributing factor to the FY09 decline was the acquisition of an internal loan to acquire the Cyr House property.

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;
- 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 FY09, UMFK’s CFI score hit a four year low at -1.6.
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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>
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</thead>
<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 UMFK’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.

On the possible scale of 0 – 10, UMFK has had strength factors of zero for at least two of its ratios during each of the past four years. Consequently, UMFK’s financial health barely registers in the center of the graph for FY06, FY07, and FY09. If we look at the graph for FY07, we see that most of UMFK’s strength for that year was in its return on net assets ratio; but, it still fell significantly short of the industry benchmark.
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Graphic Financial Profile - FY06
CFI Score of -1.2

- Primary Reserve Ratio
- Net Operating Revenues Ratio
- Viability Ratio

Graphic Financial Profile - FY07
CFI Score of .4

- Primary Reserve Ratio
- Net Operating Revenues Ratio
- Viability Ratio

Graphic Financial Profile - FY08
CFI Score of -.5

- Primary Reserve Ratio
- Net Operating Revenues Ratio
- Viability Ratio

Graphic Financial Profile - FY09
CFI Score of -1.6

- Primary Reserve Ratio
- Net Operating Revenues Ratio
- Viability Ratio

Actual | Low Benchmark - 3