University of Maine System

Ratio Analysis

January 5, 2010

KPMG LLP

Presented by:
Renee Bourget-Place
Core Financial Ratios and Composite Financial Index

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 BearingPoint. This book is widely used in the higher education industry and the most recent edition includes guidance specifically for public institutions of higher education.

The following four core ratios help answer these key questions:

- **Primary Reserve Ratio**
  Are the resources sufficient and flexible enough to support the University's mission?
  This ratio provides a snapshot of financial strength and flexibility by indicating how long the institution could function using its expendable reserves without relying on additional net assets generated by operations.
  Ratio of 40% (provides about 5 months of expenses) or better is advisable to give institutions the flexibility to manage the enterprise.

- **Net Operating Revenues Ratio**
  Do the operating results indicate that the University is living within available resources?
  A positive ratio indicates that the institution experienced an operating surplus for the year.
  A target of at least 2% to 4% is a goal over an extended time period, although the target will likely vary from year to year. A key for institutions establishing a benchmark for this ratio would first be the anticipated institutional growth in total expenses.

- **Return on Net Assets**
  Does financial asset performance support the strategic direction of the University? Institutions should establish a real rate of return target in the range of approximately 3% to 4%. The real return plus the actual inflation index, either the Consumer Price Index (CPI) or the Higher Education Price Index (HEPI), published by Research Associates in Washington, D.C., will provide the nominal rate of return.

- **Viability Ratio**
  Is debt managed strategically to advance the University's mission? Analysis of financial statements over the past three fiscal years indicates that this ratio should fall between 1.25x and 2.00x, and higher for the strongest creditworthy institutions.

When combined, these four ratios deliver a single measure of the overall financial health of the University, hereafter referred to as the Composite Financial Index.

### Ratios Calculated As Follows:

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

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

- **Return on Net Assets**
  \[
  \frac{\text{Change in Net Assets}}{\text{Total Net Assets}}
  \]

- **Viability Ratio**
  \[
  \frac{\text{Expendable Net Assets}}{\text{Long-Term Debt}}
  \]
Primary Reserve Ratio –
Expendable Net Assets to Total Expenses

- This ratio indicates the ability of the University to support current level of operations from expendable resources, without considering revenues generated from operations. A benchmark of 40% or better is considered an advisable reserve.

- Components:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expendable net assets *</td>
<td>$143,129</td>
<td>168,618</td>
<td>167,168</td>
<td>152,055</td>
</tr>
<tr>
<td>Expenses</td>
<td>$596,327</td>
<td>610,265</td>
<td>651,158</td>
<td>656,400</td>
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</table>

* Excludes expendable net assets restricted for capital
Net Operating Revenues Ratio –
*Operating Income (Loss) Plus Net Non-Operating Income to Operating Revenues Plus Non-Operating Revenues*

A positive ratio indicates the University lived within its means during the year. Generally, the larger the surplus, the stronger the institution’s financial performance as a result of the current year’s activity.

Components:

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<thead>
<tr>
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<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
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</thead>
<tbody>
<tr>
<td>Operating income (loss) plus net non-operating revenues</td>
<td>$ 8,232</td>
<td>16,193</td>
<td>2,499</td>
<td>10,825</td>
</tr>
<tr>
<td>Operating revenues plus non-operating revenues</td>
<td>$ 604,559</td>
<td>626,458</td>
<td>653,657</td>
<td>667,225</td>
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</tbody>
</table>
Return on Net Assets Ratio –
Change in Net Assets to Total Net Assets

This ratio measures whether the University is financially better off by measuring total economic return – the return on net assets that occurred as a result of the University's activities.

The nominal rate of return on net assets is the actual return calculated/unadjusted for inflation or other factors. The real rate of return adjusts the nominal rate for the effects of inflation using the Higher Education Price Index.

Components:

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in total net assets</th>
<th>Total net assets (beginning of year)</th>
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<tbody>
<tr>
<td>2006</td>
<td>$ 33,875</td>
<td>$554,663</td>
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<td>2007</td>
<td>$ 43,290</td>
<td>588,538</td>
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<tr>
<td>2008</td>
<td>$ 9,432</td>
<td>631,828</td>
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<tr>
<td>2009</td>
<td>$10,245</td>
<td>641,260</td>
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Viability Ratio –
**Expendable Net Assets to Long-Term Debt**

This ratio measures one of the most basic determinants of clear financial health – the availability of expendable net assets to cover debt should the University need to settle its obligations. A ratio of 1.25 or greater indicates the University has sufficient reserves to satisfy all liabilities, including long-term debt.

**Components:**

<table>
<thead>
<tr>
<th>Year</th>
<th>Expendable net assets*</th>
<th>Long-term debt</th>
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</thead>
<tbody>
<tr>
<td>2006</td>
<td>$143,129</td>
<td>$196,384</td>
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<tr>
<td>2007</td>
<td>168,618</td>
<td>223,779</td>
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<tr>
<td>2008</td>
<td>167,168</td>
<td>217,529</td>
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<tr>
<td>2009</td>
<td>152,055</td>
<td>212,185</td>
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* Excludes expendable net assets restricted for capital
Computing the Composite Financial Index – 
Overview of Methodology

The methodology is an arithmetic means of combining different but complementary measures (the four ratios previously displayed) of fundamental elements of financial health to yield a single measure (the composite financial index) representing an institution’s overall financial health.

Under the methodology, the composite financial index (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.
Scale for Charting – Composite Financial Index Performance

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<td>Access Institutional viability to survive</td>
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<td>Reengineer the institution</td>
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<td>Direct Institutional resources to allow transformation</td>
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<td>Focus resources to compete in future state</td>
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<td>Allow experimentation with new initiatives</td>
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<td>Deploy resources to achieve a robust mission</td>
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2008 1.5 2009 1.6