# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Primary Reserve Ratio</td>
<td>2</td>
</tr>
<tr>
<td>Net Operating Revenues Ratio</td>
<td>4</td>
</tr>
<tr>
<td>Return on Net Assets Ratio</td>
<td>6</td>
</tr>
<tr>
<td>Viability Ratio</td>
<td>8</td>
</tr>
<tr>
<td>Composite Financial Index</td>
<td>10</td>
</tr>
<tr>
<td>Graphic Financial Profile</td>
<td></td>
</tr>
<tr>
<td>Illustrated</td>
<td>13</td>
</tr>
<tr>
<td>UMPI Profiles</td>
<td>14</td>
</tr>
</tbody>
</table>
The financial health of the University of Maine at Presque Isle (UMPI) 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*, Seventh Edition published by KPMG; Prager, Sealy & Co., LLC; and ATTAIN. This book is widely used in the higher education industry and includes guidance for both private and public institutions. Ratios presented for the University of Maine System (UMS) were obtained from the separately prepared “Core Financial Ratios and Composite Financial Index” report prepared for the UMS.

According to the above publication, there are four fundamental financial questions that need to be addressed. Analysis of four core ratios can help us answer these questions.

- Are resources sufficient and flexible enough to support the mission? - **Primary Reserve Ratio**
- Do operating results indicate the institution is living within available resources? - **Net Operating Revenues Ratio**
- Does asset performance and management support the strategic direction? - **Return on Net Assets**
- Are financial resources, including debt, managed strategically to advance the mission? - **Viability Ratio**

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

Data previously presented by UMPI for FY06 through FY09 has been updated in this report to reflect the following changes made in the Seventh Edition of *Strategic Financial Analysis for Higher Education*:

- The lowest possible value for each strength factor used in calculating the Composite Financial Index (see page 10) is now -4 rather than the previous low of 0. The highest possible value remains at 10 and the low benchmark remains at 3.

- The scale for scoring the Composite Financial Index (see page 12) has been updated to reflect the new range of -4 to 10 rather than the previous range of -1 to 10.
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:

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

- A ratio of .40 (provides about 5 months) or better is advisable to give institutions the flexibility to manage the enterprise.

- 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.

- Components:

<table>
<thead>
<tr>
<th></th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expendable net assets</td>
<td>$5,224</td>
<td>$6,212</td>
<td>$5,976</td>
<td>$4,171</td>
<td>$5,012</td>
</tr>
<tr>
<td>Expenses</td>
<td>$17,095</td>
<td>$18,486</td>
<td>$20,098</td>
<td>$20,090</td>
<td>$20,076</td>
</tr>
</tbody>
</table>

- In FY09, UMPI's reserves covered about 2.5 months of expenses which was down from the 3.5 months provided in the three preceding years. In FY10, the ratio partially recovered as expendable net assets increased significantly.
• In all years except FY07, UMPI funded capital construction with unrestricted net assets. Funded projects include the Gentile Hall fitness center (FY07), Folsom-Pullen renovations (FY09), and the wind project (FY08, FY09, and FY10). Although the $2 million investment in the wind project has the short-term impact of reducing UMPI’s primary reserve ratio and its viability ratio, the investment was a strategic decision by management that should positively influence future operating results by reducing energy expenses.

• As previously mentioned, UMPI did not invest unrestricted net assets in capital construction projects during FY07; therefore, positive operating results and high endowment returns caused the primary reserve ratio to increase.

• In FY08 and FY09, negative operating results, negative endowment returns, and investments in capital construction caused the primary reserve ratio to decrease.

• In FY10, expendable net assets increased as UMPI increased operating revenues and reduced operating expenses. Also, a minimal amount of unrestricted net assets were used to fund capital construction.
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:

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

- 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.

- The authors of *Strategic Financial Analysis for Higher Education*, note the following:

  The primary reason institutions need to generate some level of surplus over long periods of time is because operations are one of the sources of liquidity and resources for reinvestment in institutional initiatives. Conversely, generating a known deficit in the short term may well be the best strategic decision a board makes, if it is an affordable investment in its future and the deficit will clearly be eliminated through specific actions.
• Components:

<table>
<thead>
<tr>
<th></th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income (loss) plus</td>
<td>$775</td>
<td>$426</td>
<td>($397)</td>
<td>($481)</td>
<td>$123</td>
</tr>
<tr>
<td>net non-operating revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating revenues plus non-</td>
<td>$17,870</td>
<td>$18,912</td>
<td>$19,700</td>
<td>$19,610</td>
<td>$20,199</td>
</tr>
<tr>
<td>operating revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

• UMPI’s ratio surpassed the high industry benchmark in FY06 but dropped off significantly in FY07 as increases in expenses began to outpace increases in operating and nonoperating revenues.

• In FY08, operating expenses outpaced revenue increases at an even greater pace, resulting in a negative return for the year.

• In FY09, operating expenses decreased slightly; however, operating and nonoperating revenues decreased significantly, resulting in an even larger negative return. The FY09 decrease in revenues primarily occurred in net student fees and noncapital State of Maine appropriation (net of State Fiscal Stabilization Program funds).

• In FY10, a 6.1% increase in operating revenues and slight decrease in operating expenses more than offset a decrease in nonoperating revenues; resulting in a positive net operating revenues ratio.
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. An improving trend in this ratio indicates that the institution is increasing its net assets and is likely to be able to set aside financial resources to strengthen its future financial flexibility. 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 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.

- 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.
Components:

<table>
<thead>
<tr>
<th>$ in thousands</th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in total net assets</td>
<td>$1,308</td>
<td>$582</td>
<td>$843</td>
<td>$91</td>
<td>$163</td>
</tr>
<tr>
<td>Total net assets (beginning of year)</td>
<td>$21,505</td>
<td>$22,813</td>
<td>$23,395</td>
<td>$24,238</td>
<td>$24,329</td>
</tr>
</tbody>
</table>

- In all five years UMPI experienced a positive nominal rate of return on net assets.
- In FY06 and FY07, operating results (see prior discussion of the net operating revenues ratio) were the primary factor in the positive return on net assets.
- Although operating results were negative in FY08, State of Maine capital appropriation revenue enabled UMPI to realize a positive return on net assets.
- FY09’s positive return on net assets was attributable to State of Maine capital appropriation revenue and a capital transfer from the System Office to partially match the capital appropriation dollars.
- FY10’s positive return on net assets was primarily attributable to positive operating results (see prior discussion of the net operating revenues ratio).
The **Viability Ratio** measures expendable resources that are available to cover debt obligations (e.g., capital leases, notes payable, and bonds payable) and generally is regarded as governing an institution’s ability to assume new debt. 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

- A ratio of 1.00 or greater indicates sufficient resources to satisfy debt obligations.

- The authors of *Strategic Financial Analysis for Higher Education*, note the following:

  There is no absolute threshold that will indicate whether the institution is no longer financially viable. However, the Viability Ratio, along with the Primary Reserve Ratio discussed earlier, can help define an institution’s “margin for error”. As the Viability Ratio’s value falls below 1:1, an institution’s ability to respond . . . , to adverse conditions from internal resources diminishes, as does its ability to attract capital from external sources and its flexibility to fund new objectives.

- 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.
Components:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expendable net assets</td>
<td>$5,224</td>
<td>$6,212</td>
<td>$5,976</td>
<td>$4,171</td>
<td>$5,012</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>$2,182</td>
<td>$2,061</td>
<td>$1,952</td>
<td>$1,907</td>
<td>$1,862</td>
</tr>
</tbody>
</table>

UMPI has not acquired new debt since FY04 when University Revenue Bonds were issued to construct the health and fitness education center. UMPI has strived to keep their debt balance low and has had the lowest level of debt in the UMS each of the past five years.

Positive operating results and high endowment returns accounted for the significant jump in the viability ratio in FY07.

Despite a decrease in expendable net assets in FY08, the viability ratio increased as the percentage reduction in outstanding debt was greater than the percentage decrease in expendable net assets.

In FY09, the viability ratio dropped as $2.2 million of restricted expendable net assets were used to fund the wind project and the Folsom-Pullen renovation project. Despite the large decline in FY09, UMPI's viability ratio still far surpassed the industry benchmark.

UMPI’s viability ratio increased again in FY10 as expendable net assets increased primarily due to positive operating results and as UMPI paid the annual debt service on outstanding debt.
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. By blending these four key measures of financial health into a single number, a more balanced view of the state of the institution’s finances is possible because a weakness in one measure may be offset by the strength of another measure.

Because the CFI only measures the financial component of an institution’s well-being, it must be analyzed in context with other associated activities and plans to achieve an assessment of the overall health of the institution. A high CFI is not necessarily indicative of a successful institution, although a low CFI generally is indicative of additional challenges. When considered in the context of achievement of mission, a very high CFI with little achievement of mission may indicate a failing institution.

The CFI is calculated by:

1. Determining the value of each ratio;
2. Converting the value of each ratio to strength factors along a common scale;
3. Multiplying the strength factors by specific weighting factors; and
4. Totaling the resulting four numbers 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.

Performance of the CFI score can be evaluated on a scale of -4 to 10 as shown on the following page.
The overlapping arrows represent the ranges of measurement that an institution may find useful in assessing itself.

We have overlaid the scoring scale with UMPI’s lowest (FY09) and most recent scores to assist in evaluating UMPI’s performance.
The strength factors that were used in calculating the CFI can be mapped on a diamond to show the shape of an institution’s financial health compared to the industry benchmarks. This **Graphic Financial Profile** can assist management in determining whether a weakness in one ratio is offset by strength in another ratio.

Illustrated below are two examples of a Graphic Financial Profile (GFP): one based on strength factors valued at the low industry benchmark of 3 and one with strength factors valued above and below the benchmark:

- The center point of the graphic financial profiles is -4 as illustrated in the Seventh Edition of *Strategic Financial Analysis for Higher Education*. An actual value that falls below -4, defaults to a value of -4 and is plotted at the center of the graph.

- The maximum value in the graph is 10; thus, an actual value greater than 10 is not plotted beyond the outer diamond.

- The smaller, heavily lined diamond represents the low industry benchmark of 3.

- The actual values of the institution’s ratio strength factors are plotted and shaded to show how the institution’s health compares with the low (3) and high (10) benchmarks.
The following graphs contain UMPI’s Graphic Financial Profiles for FY06 thru FY10. From these profiles we can see that UMPI has consistently had strength in its viability ratio and that the strength factor for the primary reserve ratio has consistently been below the low industry benchmark. Strength in the other ratios has fluctuated.

UMPI had a CFI score of 4.0 and 4.1 in FY06 and FY07, respectively; however, the shape of their diamond was quite different as their strongest ratio changed from the net operating revenues ratio in FY06 to the viability ratio in FY07.
University of Maine at Presque Isle
Core Financial Ratios and Composite Financial Index
FY06 to FY10

Graphic Financial Profile - FY07
UMPI
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 4.0

Primary Reserve Ratio
Net Operating Revenues Ratio
Viability Ratio
Return on Net Assets Ratio

Actual ▪ Low Benchmark: 3 □ High Benchmark: 10
The shape of UMPI’s diamond changed significantly for FY08 and FY09 as losses were incurred and the return on net assets and net operating revenues ratios declined significantly.

**Graphic Financial Profile - FY08**

UMPI

Strength Factors Plotted on a Scale of -4 to 10

CFI Score of 3.4

- Actual
- Low Benchmark: 3
- High Benchmark: 10
Graphic Financial Profile - FY09
UMPI
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 2.1

Primary Reserve Ratio
Return on Net Assets Ratio
Viability Ratio
Net Operating Revenues Ratio

1.58
0.19
-3.50
5.25

Actual
Low Benchmark: 3
High Benchmark: 10
In FY10, UMPI's diamond was more balanced in shape as UMPI experienced positive returns from both operations and total net assets.