# 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>UMA Profiles</td>
<td>14</td>
</tr>
</tbody>
</table>
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, 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 UMA’s overall financial health, hereafter referred to as the **Composite Financial Index**.
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:

\[
\text{Expendable Net Assets}^* \\
\text{Total Expenses}
\]

* Excluding net assets restricted for capital investments

- 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>
<th>FY11</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expendable net assets</strong></td>
<td>$6,987</td>
<td>$6,738</td>
<td>$6,562</td>
<td>$7,895</td>
<td>$9,883</td>
<td>$12,245</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td>$32,997</td>
<td>$34,815</td>
<td>$35,452</td>
<td>$41,907</td>
<td>$43,785</td>
<td>$44,876</td>
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January 2012
• 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.

• At the highest point (in FY11), UMA’s reserves provided just over three months of operating expenses.

• Expendable net assets increased in FY10 and again in FY11, as operating revenues and endowment returns outpaced the increase in expenses – see discussion of the net operating revenues ratio. In each of these years, UMA utilized $1.7 million of unrestricted expendable net assets for 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:

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

- 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.

- 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>Components:</th>
<th>$ in thousands</th>
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</thead>
<tbody>
<tr>
<td>Operating income (loss) plus net non-operating revenues</td>
<td>FY06: $934</td>
</tr>
<tr>
<td>Operating revenues plus non-operating revenues</td>
<td>FY06: $33,931</td>
</tr>
</tbody>
</table>

In accordance with generally accepted accounting principles, noncapital state appropriations are classified in the financial statements as 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 -.17% shown above.

The FY09 ratio of 9.77% 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 -.17% 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 FY10 ratio is more in keeping with the ratios for FY06 and FY07 as it is not influenced by a transfer of assets from System Wide Services as occurred in FY09.

In FY11, UMA’s ratio doubled the FY10 ratio as UMA increased operating revenues 5.9% and contained the growth in operating expenses to 2.5%.
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:

\[
\text{Change in Net Assets} = \frac{\text{Total Ending Net Assets} - \text{Total Beginning Net Assets}}{\text{Total Beginning Net Assets}} 
\]

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:**

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<tr>
<th></th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in total net assets</td>
<td>$1,103</td>
<td>$3,808</td>
<td>$435</td>
<td>$5,910</td>
<td>$3,172</td>
<td>$4,829</td>
</tr>
<tr>
<td>Total net assets (beginning of year)</td>
<td>$24,387</td>
<td>$25,490</td>
<td>$29,298</td>
<td>$29,733</td>
<td>$35,643</td>
<td>$38,816</td>
</tr>
</tbody>
</table>
Over the past six 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%.

If we compare the FY10 ratio with that for FY09 without the University College transfer, we see that the real rate of return increased from 3.3% in FY09 to 8.0% in FY10. This increase is primarily attributable to positive endowment returns in FY10 and a $1.1 million gift of property on Water Street in Augusta.

UMA’s real rate of return increased again in FY11 as the return from operations doubled (see prior discussion of the net operating revenues ratio) and endowment income not distributed for operations doubled from FY10.
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:

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

* Excluding net assets restricted for capital investments

- A ratio of 1.00 or greater indicates that there are 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:

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<td>$9,883</td>
<td>$12,245</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>$3,012</td>
<td>$2,818</td>
<td>$2,619</td>
<td>$2,460</td>
<td>$2,290</td>
<td>$3,114</td>
</tr>
</tbody>
</table>

• UMA’s ratio has surpassed both the UMS ratio and the industry benchmark in each of the past six 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’s ratio increased again in FY10 as operating revenues and endowment returns outpaced an increase in expenses, and as UMA’s debt decreased via the annual debt service payments.

• In FY11, UMA’s ratio decreased slightly as a result of UMA borrowing $1 million for construction of the College Center/Dental Health Clinic.

• UMA continues to have 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. 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.

- In five of the past six years, UMA’s CFI score was above the low industry benchmark and was well above the UMS’ score. The spike in FY09 is attributable to the transfer of University College’s net assets to UMA.

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 scale with UMA’s lowest CFI score (FY08) and most recent CFI score to assist in evaluating UMA’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 UMA’s Graphic Financial Profiles for FY06 thru FY11.

For FY06, UMA’s strength factor for the primary reserve ratio was about half of the low industry benchmark of 3.0. However, because UMA had very little outstanding debt, the viability ratio surpassed the low industry benchmark.
Capital gifts and high endowment returns contributed to the FY07 shift in UMA’s financial strength to the left side of the graph.

**Graphic Financial Profile - FY07**

UMA

Strength Factors Plotted on a Scale of -4 to 10

CFI Score of 4.3

*Actual*  •  *Low Benchmark: 3*  •  *High Benchmark: 10*
In FY08, the shaded area was much thinner as UMA experienced a minimal return on its total net assets and a negative return from operations. The strength of UMA’s viability ratio continued to increase as UMA made scheduled payments on its outstanding debt.
The transfer of University College to UMA in FY09 contributed to the higher returns in that fiscal year. Despite the high returns, the strength factor for the primary reserve ratio was unchanged at a little less than half of the low industry benchmark.
In FY10, the strength factor for the viability ratio reached the high industry benchmark as UMA’s actual viability ratio reached .99x.
In FY11, the strength factor for the viability ratio dropped back below the high industry benchmark as UMA acquired additional debt. The primary reserve ratio strength factor remains below industry benchmarks while strength factors for the remaining three ratios are significantly greater than the low benchmark of 3.

**Graphic Financial Profile - FY11**

**UMA**

Strength Factors Plotted on a Scale of -4 to 10

CFI Score of 6.1