University of Maine at Presque Isle

Core Financial Ratios and Composite Financial Index

FY06 to FY13
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Change in Terminology from Prior Reports

In FY13, the University of Maine System adopted Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Pursuant to the provisions of Statement No. 63, all University of Maine System campuses including the University of Maine at Presque Isle updated their financial statements to reflect the residual measure in the statement of net position as net position, rather than net assets. For consistency with the financial statements, we have updated this ratio report to reference net position rather than net assets. This change in terminology has no impact on the calculation of each core ratio or the core financial index.

Overview

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

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

* Excluding net position restricted for capital investments

Key items that can impact the primary reserve ratio include principal payments on debt, use of unrestricted net position to fund capital construction projects, operating results (operating revenues – operating expenses + nonoperating revenues – nonoperating expenses + depreciation), endowment returns, and total operating expenses.

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

In FY13, UMPI’s primary reserve ratio remained unchanged from the prior year and expendable net position covered not quite 4 months of expenses.
Highlights:

In all years except FY07, UMPI funded capital construction with unrestricted net position. Funded projects include the Gentile Hall fitness center (FY06), Folsom-Pullen renovations (FY09 and FY12), the wind project (FY08, FY09, and FY10), and the Emerson Hall boiler (FY13). Although the $2 million investment in the wind project had the short-term impact of reducing UMPI’s primary reserve ratio and its viability ratio, the investment was a strategic decision by management to positively influence future operating results by reducing energy expenses.

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

FY08/FY09: Negative operating results, negative endowment returns, and investments in capital construction caused the primary reserve ratio to decrease in each of these years.

FY10: Expendable net position increased as UMPI increased operating revenues and reduced operating expenses. Also, a minimal amount of unrestricted net position was used to fund capital construction.

FY11: UMPI’s primary reserve ratio increased again in FY11 as UMPI experienced significantly higher operating and endowment returns than in FY10. State of Maine capital appropriations and capital grants and gifts were available to UMPI in FY11 to fund capital construction; therefore, the amount of unrestricted net position needed to fund such activities was minimal.

FY12: Despite negative endowment returns, UMPI’s primary reserve ratio increased slightly in FY12 as UMPI experienced a positive return from operations after adding back depreciation which impacts net position invested in capital assets rather than expendable net position.

FY13: UMPI’s primary reserve ratio remained unchanged from the prior year as the increase in expendable net position was offset by an increase in expenses. UMPI used less than $100 thousand of unrestricted net position for construction in FY13.
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 position and, thereby, impact the other three core ratios: Primary Reserve, Return on Net Position, and Viability. This ratio is calculated as follows:

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

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.

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.

UMPI’s return from operations has fluctuated significantly over the past eight years with the highest return occurring in FY06 and the lowest return occurring in FY13.
### Highlights:

**FY07:** 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.

**FY08:** Operating expenses outpaced revenue increases at an even greater pace than in FY07, resulting in a negative return for FY08.

**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).

**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.

**FY11:** UMPI increased student fees revenue, utilized more of available State Fiscal Stabilization monies, and contained the growth in expenses to 1.5%, resulting in its second highest ratio in the period from FY06 to FY11.

**FY12:** Decreases in net student fees revenue, noncapital grants revenue, and State Fiscal Stabilization revenue combined with an increase in operating expenses, resulted in a negative return from operations in FY12.

**FY13:** UMPI’s net operating revenues ratio was negative again, as operating revenues decreased primarily due to a drop in enrollments combined with a system-wide freeze of in-state tuition rates and mandatory unified fees. Operating expenses increased again in FY13, reaching an eight-year high.
The **Return on Net Position 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 position. An improving trend in this ratio indicates that the institution is increasing its net position and is likely to be able to set aside financial resources to strengthen its future financial flexibility. This ratio is calculated as follows:

**Change in Net Position**

Total Beginning of the Year Net Position

Items that may impact this ratio include those that impact the net operating revenues ratio, along with endowment returns, capital appropriations, capital grants and gifts, capital transfers, and endowment gifts.

The nominal rate of return on net position is the actual return 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 (HEPI).

Although UMPI’s nominal rate of return has only been negative once in the past eight years, its real rate of return has been negative five times, with the lowest real rate of return occurring in FY13.
Highlights:

**FY06/FY07:** Operating results (see prior discussion of the net operating revenues ratio) were the primary factor in the positive return on net position.

**FY08:** Although operating results were negative in FY08, State of Maine capital appropriation revenue enabled UMPI to realize a positive return on net position.

**FY09:** The positive return on net position 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:** The positive return on net position was primarily attributable to positive operating results (see prior discussion of the net operating revenues ratio).

**FY11:** UMPI’s real rate of return was positive for the first time since FY07. Positive operating results and $1 million in capital grants and gifts revenue were the primary contributors to the FY11 ratio.

**FY12:** The positive return on net position in FY12 is attributable to items such as State of Maine capital appropriations revenue and capital grants and gifts revenue which totaled $1 million. The FY12 ratio is, however, significantly lower than that for FY11 because of negative returns from operations and endowments in FY12 and a decrease in the level of funding from capital grants and gifts.

**FY13:** UMPI’s return on net position ratio fell significantly from FY12 to FY13 as UMPI experienced a $641 thousand loss from operations, and capital appropriations revenue and capital grants and gifts revenue collectively decreased $1 million as these sources of funding had been spent in full in prior fiscal years.

### Ratio Components

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<tr>
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<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
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<tr>
<td>Change in total net position</td>
<td>$1,308</td>
<td>$ 582</td>
<td>$ 843</td>
<td>$ 91</td>
<td>$163</td>
<td>$1,914</td>
<td>$ 918</td>
<td>$(550)</td>
</tr>
<tr>
<td>Total net position (beginning of year)</td>
<td>$21,505</td>
<td>$22,813</td>
<td>$23,395</td>
<td>$24,238</td>
<td>$24,329</td>
<td>$24,492</td>
<td>$26,406</td>
<td>$27,324</td>
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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:

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

* Excluding net position 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 position to fund capital construction projects, operating results (operating revenues – operating expenses + nonoperating revenues – nonoperating expenses + depreciation) and endowment returns. Issuance of new debt would also impact the ratio.

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.

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

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 its debt balance low and has had the lowest level of debt in the UMS each of the past eight years.
Highlights:

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

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

FY09: The viability ratio dropped as $2.2 million of restricted expendable net position 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.

FY10/FY11: UMPI’s viability ratio increased again in FY10 and FY11 as expendable net position increased primarily due to positive operating results and as UMPI paid the annual debt service on outstanding debt.

FY12/FY13: UMPI’s viability ratio increased again in FY12 and FY13 as expendable net position increased primarily due to positive operating results after adding back depreciation expense 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 position 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.

The CFI is calculated by completing the following steps:

1. Compute the values of the four core ratios;
2. Convert the ratio values to strength factors along a common scale;
3. Multiply the strength factors by specific weighting factors; and
4. Total the resulting four numbers (ratio scores) to reach the single CFI score.

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.

A score of 1.0 indicates very little financial health; 3, the low benchmark, represents a relatively stronger financial position; and 10 is the top of the scale.

Although higher than that of the UMS, UMPI’s CFI score has generally trended in the same direction as the UMS’ CFI.
Performance of the CFI score can be evaluated on a scale of -4 to 10 as shown on the following page. 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.
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), highest (FY11) 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 plots actual strength factors that equal the low industry benchmark of 3 and one that plots actual strength factors that fall above and below the low benchmark:

- The center point of the graphic financial profiles is -4, the lowest possible score on the scale.
- The smaller, heavily lined diamond in the graphs represents the low industry benchmark of 3.
- The outer, lightly lined diamond represents the high industry benchmark of 10 and the highest possible score on the scale for each ratio.
- 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) industry benchmarks. In the left graph, the plotted actual values fill the smaller diamond as each of the actual values is at the low benchmark of 3. In the right graph, the smaller diamond is not filled as the actual values of two ratios fall below the low industry benchmark of 3. Also, in the right graph, part of the outer diamond is filled as values for two of the ratios surpass the low benchmark of 3.
The following graphs contain UMPI’s Graphic Financial Profiles for FY06 thru FY13.

UMPI had a CFI score of 4.1 and 4.0 in FY06 and FY07, respectively; however, the shape of the diamond was quite different as UMPI’s strongest ratio changed from the net operating revenues ratio in FY06 to the viability ratio in FY07.

**Graphic Financial Profile - FY06**
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 4.1

**Graphic Financial Profile - FY07**
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 4.0
The shape of UMPI’s diamond changed significantly for FY08 and FY09 as losses were incurred and the return on net position and net operating revenues ratios declined significantly.

**Graphic Financial Profile - FY08**
Strength Factors Plotted on a Scale of -4 to 10  
CFI Score of 3.4

**Graphic Financial Profile - FY09**
Strength Factors Plotted on a Scale of -4 to 10  
CFI Score of 2.1
**FY10:** UMPI’s diamond was more balanced in shape as UMPI experienced positive returns from both operations and total net position.

**FY11:** UMPI experienced its highest CFI score of the six years ended FY11 as the strength factors for three of its ratios surpassed the low industry benchmark and the strength factor for the viability ratio neared the high industry benchmark.
FY12: The shape of UMPI’s diamond remains similar to that for FY10 and FY11; however, the plotted area is smaller than it was in FY11 as UMPI experienced a negative return from operations and a much smaller return on net position in FY12. The strength factor for the viability ratio continues to surpass the low industry benchmark of 3 and is nearing the high benchmark of 10.

FY13: The shape of UMPI’s diamond changed significantly in FY13 as the strength factor for UMPI’s FY13 net operating revenues ratio is at the lowest value on the scale of -4 to 10.

**Graphic Financial Profile - FY12**
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 4.3

**Graphic Financial Profile - FY13**
Strength Factors Plotted on a Scale of -4 to 10
CFI Score of 3.5