• Explanation of categories of net position
• Operating reserves discussion
• Ratios and benchmarking
Net position is the residual of all other elements presented in a statement of financial position. Net position is displayed in 3 components:

- Net investment in capital assets
- Restricted
  - Nonexpendable
  - Expendable
- Unrestricted
Here is a snapshot of the System’s Net Position as reported in the financial statements:

<table>
<thead>
<tr>
<th>NET POSITION (in thousands)</th>
<th>2014</th>
<th>2013 (Restated)</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net investment in capital assets</td>
<td>$531,654</td>
<td>$511,107</td>
<td>$500,486</td>
</tr>
<tr>
<td>Restricted:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonexpendable</td>
<td>56,945</td>
<td>56,187</td>
<td>55,362</td>
</tr>
<tr>
<td>Expendable</td>
<td>109,576</td>
<td>99,955</td>
<td>92,863</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>179,162</td>
<td>183,219</td>
<td>176,632</td>
</tr>
<tr>
<td>Total Net Position</td>
<td>$877,337</td>
<td>$850,468</td>
<td>$825,343</td>
</tr>
</tbody>
</table>
The net investment in capital assets component of net position generally consists of:

- The cost of capital assets,
- Minus accumulated depreciation,
- Minus the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

**NOTE:** Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also would be included in this component of net position.
This category reflects the difference between the amount reported for capital assets, net (net book value) minus the outstanding debt incurred to finance those capital assets.

“Bricks and mortar” component of net position

Not usually available in cash without having to sell assets
The System’s net investment in capital assets over the past three years (2012 is before GASB 65 restatement):
• The restricted component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets.

• Represents resources that are constrained to a particular purpose or require the passage of time before the resources can be used.

• There are 2 categories of restricted net position:

  • Nonexpendable - funds received must be retained in perpetuity. These funds can never be spent.

  • Expendable – can be spent, but only for a specific purpose and/or when a time restriction expires, which is established by the provider of resources (such as a donor or grantor).

Donors/Grantors RESTRICT, Boards DESIGNATE
RESTRICTED, NONEXPENDABLE

• Consists entirely of donor endowment funds

• Where the donor has said the original gift (and sometimes additional gifts or income) is to be *permanently* endowed

• Income generated from the gift is available to support purposes directed by the donor
  • Scholarships
  • Research
  • Library

• Spending limited by law
  • MRS Title 13, Chapter 99: UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT (UPMIFA)
RESTRICTED, EXPENDABLE

• Consists of funds restricted for a particular purpose and/or time

  • Where a donor or grantor has said they will give money to the organization in order for the System to do something specific (purpose restriction)

  OR

  • The System cannot use the funds until a period of time has passed (time restriction)

Includes accumulated gains on true endowment funds, restricted gifts, interest income on Perkins loans among other things
A CAUTIONARY TALE

Georgetown University Sued by Donor Scott K. Ginsburg

Princeton Setsles Lawsuit Over $900 Million Endowment (Update3)

Colleges must respect donor intent

Plaintiff in case against Hopkins says institutions face risk when they don't abide by givers' wishes

Heirs Sue Tulane for Closing Historic Women's College
The System’s restricted net position over the past three years:

- **Restricted Nonexpendable**
  - 2014: $56,945
  - 2013: $56,187
  - 2012: $55,362

- **Restricted Expendable**
  - 2014: $109,576
  - 2013: $99,955
  - 2012: $92,863
RESTRICTED EXPENDABLE NET POSITION

RESTRICTED EXPENDABLE, BY CATEGORY (IN THOUSANDS)

- Student Financial Aid
- Capital Assets and Retirement of Debt
- Loans
- Academic Support
- Research and Public Service
- Library
- Other

• Consists of funds that are NOT capital asset related and are NOT restricted for a particular purpose or the passage of time.

• Unrestricted net position may be committed by actions of the System’s Board of Trustees.

• It is important to note that it is not all sitting in a cash account – let’s look at a simple example
## UNRESTRICTED NET POSITION

<table>
<thead>
<tr>
<th>NET POSITION (in thousands)</th>
<th>Example 1</th>
<th>Example 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$1,500</td>
<td>$2,100</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>55,000</td>
<td>64,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>5,000</td>
<td>5,100</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(56,500)</td>
<td>(70,000)</td>
</tr>
<tr>
<td>Unrestricted Net Position</td>
<td>$5,000</td>
<td>$1,200</td>
</tr>
</tbody>
</table>
The System’s unrestricted net position over the past three years:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Position (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$176,632</td>
</tr>
<tr>
<td>2013</td>
<td>$183,219</td>
</tr>
<tr>
<td>2014</td>
<td>$179,162</td>
</tr>
</tbody>
</table>
UNRESTRICTED NET POSITION

UNRESTRICTED, BY DESIGNATION (IN THOUSANDS)

- Educational and General Reserves
- Risk Management
- Budget Stabilization
- Auxiliary Enterprises
- Benefit Pool Carryover
- Information Technology Initiative
- Internally Designated Projects
- Facility Projects
- Endowment Earnings
- Cost Sharing and Other

2014
2013
2012
• Operating reserves are the portion of unrestricted net position that boards maintain or designate for use in emergencies to sustain financial operations in the unanticipated event of significant unbudgeted increases in operating expenses and/or losses in operating revenues.

• Basically, it is an accumulation of surpluses that are available for use at the discretion of an organization’s board.
UNRESTRICTED OPERATING RESERVES

WHY HAVE AN OPERATING RESERVE

- Allow the System time to respond to change in the economic environment
- Sustain the System through temporary cash flow crisis that could result from delayed payments or funding cutbacks
- Give donors, funders and ratings agencies confidence
- Indicator of prudent/forward thinking management
- Demonstrate commitment to reliable program delivery and sustainability
What does it mean to be financially stable?

AND

What are adequate operating reserves?
The minimum operating reserve ratio can be calculated based on:

- Percentage
- Number of Months

Rule of Thumb is at the lowest point during the year

- 25% or
- about 3 months of the annual operating expense budget
After that there is no “Right Answer” – it depends on a number of factors

- Revenue volatility factors
- Spending flexibility factors
- Governance & Management factors
- Future capital needs
- Level of programmatic risk
- Risk management factors
FINANCIAL HEALTH QUESTIONS

- Are resources sufficient and flexible enough to support the mission?
- Do operating results indicate the institution is living within its available resources?
- Does financial asset performance support the strategic direction?
- Is debt managed strategically to advance the mission?

SOURCE: Strategic Financial Analysis for Higher Education, 7th Edition © 2011 by KPMG LLP; Prager, McCarthy & Sealy LLC; and ATTAIN
RATIOS AND BENCHMARKING

COMPOSITE FINANCIAL INDEX

- Four Core Ratios are calculated independently:
  - Primary Reserve Ratio
  - Net Operating Revenues Ratio
  - Return on Net Position
  - Viability Ratio

- These ratios can then be combined to produce a single measurement of financial performance based on applied strength and weight factors

- Result is the Composite Financial Index (CFI)
RATIOS AND BENCHMARKING

COMPOSITE FINANCIAL INDEX

Resources:
  Primary Reserve Ratio

Operating Results:
  Net Operating Revenues Ratio

Asset Performance:
  Return on Net Position Ratio

Debt Management:
  Viability Ratio

Composite Financial Index
Primary Reserve Ratio

Year

Percentage

2013 2012

Maine CCS
Rhode Island
Vermont
New Hampshire
Maine
Connecticut
Rutgers
Massachusetts

Threshold
Return on Net Position Ratio

Percentage

Year

2013 2012

-10% -5% 0% 5% 10% 15% 20% 25%

Maine CCS
Rhode Island
Vermont
New Hampshire
Maine
Connecticut
Rutgers
Massachusetts
Viability Ratio

Year

2013
2012

Percentage

0%
50%
100%
150%
200%
250%
300%

Maine CCS
Rhode Island
Vermont
New Hampshire
Maine
Connecticut
Rutgers
Massachusetts
RATIOS AND BENCHMARKING

Scale for Charting CFI Performance

Scoring Scale

-4  -3  -2  -1  0  1  2  3  4  5  6  7  8  9  10

Consider whether financial exigency is appropriate

Consider structured programs to conserve cash

Assess debt and ED compliance and remediation issues

Consider substantive programmatic adjustments

Reengineer the institution

Direct resources to allow transformation

Focus resources to compete in a future state

Allow experimentation with new initiatives

Deploy resources to achieve robust mission
Composite Financial Index (CFI)

Year

Score

-1

0

1

2

3

4

5

6

7

2013

2012

Maine CCS
Rhode Island
Vermont
New Hampshire
Maine
Connecticut
Rutgers
Massachusetts
QUESTIONS?
Renee Bishop, CPA
Principal
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This information is intended solely for the information and use of the Board of Trustees and management and is not intended to be, and should not be, used by anyone other than these specified parties.