

**ANALYSIS OF THE FINANCIAL REPORTS
OF THE UNIVERSITY OF MAINE**

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INTRODUCTION

My comments refer to the Financial Reports for the University of Maine for the years ending June 30, 1987 through 2005. These Financial Reports were prepared by KPMG LLP or Coopers and Lybrand as well as by the management of the University of Maine. The Tables included in this document were compiled from those Financial Reports. Any errors that might have existed in those Financial Reports may also be reflected in this document.

FUNDAMENTALS OF FUND ACCOUNTING

In order to understand the overall financial condition of any institution of higher learning in the United States, one must be aware that the accounting principles applied to the finances of such an institution involve distinct, but interrelated, entities called “funds.” Each fund has a self-balancing set of assets, liabilities, and a fund balance. One must examine all of the funds of an institution in order to assess its financial status.

An analogy to fund accounting is the following. Suppose that your assets consisted of five bank accounts, each with \$10,000 in it as of a certain date. Your net worth, if you had no debts, would then be \$50,000 and would remain unaffected by moving funds from one bank account to another. Similarly, assets are often moved between funds of a college. Consequently, the Tables included in this document present the aggregate total of the net assets in all of the funds of the University of Maine.

There are different types of funds. “Unrestricted” funds are those solely under the control of the institution’s governing board. These are the funds which allow the institution flexibility in addressing its various needs. Although there may be some “restrictions” placed on the use of unrestricted funds, these “restrictions” normally refer only to resolutions of the governing board which may be rescinded at any time by action of that board.

By contrast, “restricted” funds are resources which have external, legally binding restrictions placed upon their use. For example, a government grant (minus any indirect cost in the award, which can be treated as unrestricted revenue) can only be expended for the purpose for which it was awarded. Similarly, gifts sometimes carry legally binding stipulations

restricting their usage. Thus, a school's administration and governing board are not at liberty to use restricted funds except for stated purposes. However, in some cases, even these funds can be expended for activities which free up unrestricted funds. Expendable restricted net assets may be used for approved purposes. Nonexpendable restricted net assets are assets that donors have stipulated must be maintained permanently with only the income earned thereon available for current use. Invested in capital assets, net of related debt, is the net value of the physical plant and equipment, adjusted for depreciation.

You may wish to refer to Chapter 2, Fund Accounting, of the *Budget Handbook for Association Leaders in Higher Education Units*, which I wrote for the National Education Association. That Chapter expands upon the prior comments and illustrates them for a fictitious college.

I have reviewed the audited Annual Financial Report for the University of Maine

System for the year ending June 30, 2005 as well the FY 2006 Operating Budget.

PRIOR BUDGETARY ANALYSES

I previously submitted the financial tables which I had prepared in November 1993 for the years ending June 30, 1987 through June 30, 1993. I therefore enclose a copy of Tables 3,4, and 5 from that earlier report.

I later added updated Tables 3, 4 and 5 for years ending June 30, 1994 through June 30, 2001, labeled Tables 3, 4 and 5 Continued. I also enclose copies of Tables 3, 4 and 5 Continued.

One should note that there is less information about the transfers from the current funds in the Financial Reports for fiscal 1994 through 2000 than from the earlier Financial Reports. The earlier reports separated transfers into mandatory and non-mandatory categories and also provided a separate Table of Changes in Fund Balances. Thus my Table 3 for 1987-1993 has more details about the transfers than does my Table 3 Continued for fiscal 1994-2000. However, the 2001 Financial Report (page 26) does break down the transfers into Mandatory and Non-mandatory) as follows:

Mandatory Transfers from Current Funds:	\$7,331,919
Non-Mandatory Transfers from Current Funds	\$8,211,130
Total Transfers from Current Funds	\$15,543,049

Thus the Current funds would have shown an additional increase in Unrestricted and Restricted funds of \$8,211,130 had these Non-Mandatory transfers not been made. \$8,187,270 of the Non-Mandatory Transfers were made to the Plant Fund.

I have calculated the percentages for each revenue and expenditure category in Table 3 Continued and present those figures in Table 4 Continued. These percentages may be compared with those from Table 4 for 1987-1993. There does not seem to be any significant difference for the Fiscal 2001 data compared to the prior years, except for a decrease in Instruction of 1% and an increase in Research expenditures of 1% of total Expenditures and Transfers. Note that all of the percentages in Table 4 Continued for Revenues are taken as a percentage of Total Revenues and the percentages for Expenditures and Transfers are given as a percentage of Total Expenditures/Transfers i.e., for Fiscal 2001, the 26% for Instruction = $\$129,312,785/\$490,310,784$. Note that one adds the absolute value of the negative Transfers to the Total Expenditures to get the Total Exp/Transfers number.

Table 5 Continued lists the Fund Balances for the University of Maine System. However, I had to input new numbers for the Fiscal 2000 Fund Balances from the 2001 Financial Report because of Note 2 (page 30) of the 2001 Financial Report, which stated that “Certain Prior year items in the accompanying statements have been reclassified, without effect on total fund balances, to conform to the current year’s format.”

In particular, part of the 2000 Unrestricted funds and Endowment funds have been reclassified as Unexpended Plant Funds. The Unrestricted Funds consist of Unrestricted Current Funds and Quasi-endowment Funds. In the 2000 Financial report, the Unrestricted Current Funds had three components (see page 26 of the 2000 Financial Report): Unrestricted, Appropriated and Designated. On pages 22 and 23 of the 2000 Financial Report, it states: “Current Appropriated Funds represent reserves established principally to meet obligations for employee benefit programs and auxiliary enterprises.”

“Current Designated Funds are unrestricted funds for which the Board of Trustees or administration stipulates a specific use, thereby “designating” them for that purpose only.

However, the Board of Trustees may at any time redesignate the funds for another use.

Current Unrestricted Funds, comprised of educational and general operations of the System and of appropriations, gifts and grants, may be used at the discretion of the Board of Trustees or their designees to meet current expenditures for any purpose.”

As of June 30, 2000 the breakdown of these 3 kinds of Current Unrestricted Funds are:

Current Funds -unrestricted	\$710,110
Current Funds -appropriated	\$19,443,958
Current Funds-designated	\$25,271,321
Total	\$45,425,389

The 2001 Financial Report does not provide any breakdown of the Unrestricted Current Funds and it contains the following definition of Current Unrestricted Funds (page 29 of the 2001 Financial Report): “Current Unrestricted Funds, comprised of educational and general operations of the System and of appropriations, gifts, or grants may be used at the discretion of the Board of Trustees or their designees to meet current expenditures for any purpose.”

As to Quasi-endowment funds, the 2001 Financial Report states on page 29 (Endowment Funds): “Quasi-endowment Funds, established from time to time by the Board of Trustees, serve the same purpose as Endowment Funds, but both principal and income of Quasi-endowment funds may be expended”. Therefore, Quasi-endowment funds are Unrestricted Funds at the disposal of the Board of Trustees, as are Unrestricted Current Funds.

Unrestricted Funds increased from \$35,214,759 on June 30, 1998 to \$47,999,404 on June 30, 2001 before GASB35 was applied. Restricted Funds increased from \$145,499,768 on June 30, 1998 to \$184,597,198 on June 30, 2001 and the Net Investment In Plant increased from \$207,895,566 to \$229,100,238 over the same period of time. **If we sum all three categories of funds, the total fund balances increased from \$388,610,093 as of June 30,1998 to \$461,696,840 as of June 30 2001).**

Note that the increase of about 21 million dollars in Net Investment in Plant between June 30, 1998 and June 30, 2001 occurred in spite of the physical plant being depreciated by about 65 million dollars over that three year period. **Thus the University had to have spent at least $21 + 65 = 86$ million dollars on new buildings and capital equipment or repayment of debt principal over these three years.**

I should note that I have been conservative in considering all of the Plant Unexpended funds and Plant Indebtedness funds to be Restricted. The auditors indicate in Note 10 on page 34 of the 2001 Financial Report that “Unexpended plant funds include funds restricted for additions and improvements to plant facilities.” They did not state that ALL the unexpended plant funds were restricted funds, which is what I have conservatively assumed in my Table 5 Continued

I have added Tables 6 and 7 which presents the changes in student headcount versus numbers of “regular” staff and numbers of “regular” faculty as well as FTE numbers of staff and faculty. Note that over the period Fall, 1987 to Fall, 2004 the headcount number of students increased from 29,428 to 34,253. In Fall 2004 the 122 student headcount decrease relative to Fall 2003 was due to an increase of 295 full-time students and a decrease of 417 part-time students.

Note 2 (page 28) of the 2001 Financial Report stated that the application of Government Accounting Standards Board (GASB) No. 33 for the System's fiscal year ending June 30, 2001 meant that gift income is now recorded when pledged rather than when received. This resulted in a net increase of \$2.8 million in assets and gift income.

GASB 35 REPORTING CHANGES FOR FISCAL 2002 AND LATER YEARS

As of July 1, 2001, GASB Statements 34,35,36, 37 and 38 were adopted by the Maine System. These substantially changed the format of the 2002 and all future annual financial statements.

The new financial reports each contain a section called "Management's Discussion and Analysis. The balance Sheet has been replaced by a Statement of Net Assets (see page 22 of the 2005 Financial Report). This presents the Net Assets in 4 categories: Unrestricted, Restricted-Non Expendable, Restricted-Expendable, and Invested in Capital Assets, Net of Related Debt. On page 28 of the 2005 Financial Report the definitions of the 4 categories of net assets are:

"Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, repair or improvement of those assets. It also includes the unamortized issuance costs and premiums/discounts related to the outstanding debt. This category excludes the portion of debt attributable to unspent bond proceeds.

Restricted-nonexpendable: Net assets subject to externally imposed conditions that the System maintain them in perpetuity.

Restricted-expendable: Net assets whose use is subject to externally imposed conditions that can be fulfilled by actions of the System or by the passage of time.

Unrestricted: All other categories of net assets. Unrestricted assets may be designated by actions of the System's Board of Trustees.”

Table 5 Under GASB 35 lists these amounts for June 30, 2001 through June 30, 2005. Some of the amounts for 2001 were restated in the 2003 Financial Report and those are the amounts appearing in Table 5 Under GASB 35. Similarly, some of the amounts for fiscal 2003 were restated in the 2004 Financial Report and those restated amounts are used in Table 5. Figure 4 depicts the Unrestricted Funds under GASB 35 and Figure 5 depicts the Invested in Capital Assets, Net of related Debt, under GASB 35.

Note that there are differences in the amounts listed for asset categories under GASB 35 compared to the prior accounting systems. For example, in Table 5 Continued, Unrestricted Funds are listed as being \$47,999,404 as of June 30, 2001. On Table 5 Under GASB 35 Unrestricted Assets are listed as being \$40,510,000 as of June 30, 2001. It is because of these differences that I had to start new Tables 3, 4 and 5 Under GASB 35 in order to compare the financial data for the University of Maine System using a consistent set of accounting principles.

The June 30, 2001 restated totals comes from page 11 of the 2003 Financial Report. As Table 5 Under GASB indicates, **the Unrestricted Fund Balance increased from \$40,510,000 as of June 30, 2001 to \$59,991,000 as of June 30, 2005, an increase of nearly 20 million dollars in four years.**

On page 13 of the 2005 Financial Report it says that:

“Unrestricted Net Assets as of June 30, 2005 designated for:

Specific Projects	\$7,708,000
Operational and Capital Needs	\$45,115,000
Endowment Funds	<u>\$7,068,000</u>
TOTAL	\$59,991,0000

Note that these uses are the intention of the administration/Board. They are not legally committed because then these funds would be categorized as Restricted.

In the 2005 Financial Report, page 24, the Statement of Revenues, Expenses and Changes in Net Assets replaces the Statement of Current Fund Revenues, Expenditures and Changes in Fund Balances from the pre GASB 35 Financial Reports. Here the definitions of some of the revenue and expenditure categories have changed. For example, student tuition, dining, residence and other fees are presented net of scholarships and fellowships applied to the students accounts (see Note 1, 1 on page 32 of the 2005 Financial Report). This reduces both the Tuition and Fees Revenue component as well as the Student Aid Expenditure component, and thus affects the relative percentages of all Expenditures. Thus there is a discontinuity in trying to continue Tables 3 and 4 for the 2002, 2003, 2004 and 2005 fiscal years. Instead, I have commenced Tables 3 and 4 Under GASB35, beginning with the year ended June 30, 2002. The percentages for the year ended June 30, 2002 for Expenditures for Instruction, Research etc do differ (in some cases such as Student Aid the difference is substantial) from the percentages in Table 4 Continued.

Tables 3 and 4 Under GASB will provide trend analysis for Revenues and

Expenditures in the future as additional years are added to fiscal 2002, 2003, 2004 and 2005 under the GASB 35 format. There are only small difference in the percentages between fiscal 2002 and fiscal 2005. Research and Academic Support have increased slightly while Depreciation and Amortization, institutional support and student aid have each decreased.

One should note the on pages 18 of the 2005 Financial Report it states that Compensation and Benefits cost \$356,262,000 for the year ended June 30, 2005, \$344,086,000 for the year ended June 30, 2004, and \$325,745,000 for the year ended June 30, 2003. This represented 61.7% of the total Operating Expenses for 2003, it represented 62.3% and for 2004 and 63.3% for 2005, ie this is an increasing trend, but is at the lower end of the 60%-80% range typical for compensation in higher educational institutions. The increase in compensation and benefits cost was about 5.6% between fiscal 2003 and fiscal 2004 but only about 3.5% between fiscal 2004 and fiscal 2005: the increase between fiscal 2004 and fiscal 2005 was significantly smaller than the increase between fiscal 2003 and fiscal 2004. On page 18 of the 2005 Financial Report it stated that “This increase in 2005 and 2004 is the result of increased health care costs, annual employee compensation increases, and employment growth.”

On page 14 of the 2005 Financial Report it stated that the total capital construction before depreciation was \$54,979,000 (it was \$58,329,000 for fiscal 2004 and \$54,567,000 for fiscal 2003). These represent very large capital investments. More money was invested in capital assets than might appear from Table 5 Under GASB 35 because of depreciation (\$19,928 in fiscal 2005).

On page 19 of the 2005 Financial Report, under Management’s Discussion and Analysis, it stated “Operating revenues from Net Student fees, Grants and Contracts, and Indirect Cost

Recovery increased in FY 2005 and are expected to increase in FY 2006.” It goes on to note that “From a fiscal perspective, the most significant economic factor is the State of Maine’s continued financial difficulties and its impact on the system. Although the State Appropriation received for FY 2005 increased over the amount received for FY 2004, the total is still below the original budgeted appropriation for FY 2003 of \$183,000,000.” The System’s FY2004 state appropriation was originally budgeted at \$177 million. Due to the State’s financial situation, the system ultimately received \$172 million in state appropriation—a decrease of \$5 million. The State appropriation for FY 2005 was about \$180 million.

FUNDING OF RETIREMENT PLANS

I was asked whether the University was funding both the Basic Retirement Plan and the Defined Benefit Plan for Classified Employees from excess funds in the Defined Benefit Plan. The answer is no. On page 48 of the 2005 Financial Report it states that “During fiscal years 2005 and 2004 the System funded \$0 and \$595,000 of employer contributions to the Basic Plan through the transfer of excess assets from the Defined Benefit Plan.” On page 45 of the 2005 Financial Report it stated that the System’s pension expense for the Basic Retirement plan was \$2,922,000 for fiscal 2005 and \$2,177,000 for fiscal 2004. Clearly none of the 2005 expense was covered by the transfer of excess funds and only \$595,000 of the fiscal 2004 expense was transferred from the excess in the Defined Benefit Plan. Note that the assets and liabilities of the Defined Benefit Plan Trust are not included in the financial statements for the System (see page 47 of the 2005 Financial Report). The amount of the “overfunded actuarial accrued liability” in the Defined Benefits Plan was \$5,964,000 as of June 30, 2005 so in the future additional payments could be made from the Defined Benefits Plan Trust to defray some of the costs of the

Basic Plan.

GROWTH IN CENTRAL OFFICE

I was also asked about the perceived significant growth in the system central office during the past two years. One part of the Strategic Plan was the Centralization or Regionalization of Administrative Service at a supposed cost savings of \$3 million annually. Page 19 of the 2005 Financial Report states “Currently, extensive research is ongoing in the areas of centralized services as functional areas are being assessed on the feasibility of centrally performing certain tasks in conjunction with the System’s implementation of PeopleSoft.” It thus seems that they have not yet completed this process and the 2005 Financial Report does not break down costs to a level that separately states the cost of central administration. In addition, these costs may be spread across a number of Expense Categories, such as Institutional Support, Student Services and Academic Support.

UNIVERSITY OF MAINE FOUNDATIONS

Finally, the **various foundations of the University of Maine had assets of \$137,252,000 as of June 30, 2004 and assets of \$158,643,000 as of June 30, 2005 (page 23 of the 2005 Financial Report), an increase of over \$21 million in one year. \$12,678,000 of these funds are Unrestricted. The single largest foundation, the University of Maine Foundation, had Net Assets of \$129,912,000 as of June 30, 2005 (see page 51 of the 2005 Financial Report) . During 2004-05, the Unrestricted Foundation funds decreased by \$1,671,000.**

POST-EMPLOYMENT MEDICAL BENEFITS

The document entitled “FY 2006 Operating Budget”, on page 44 noted that GASB 45 mandates accrual accounting and actuarial valuation for post retirement health benefits, effective in fiscal

year 2008. At present these are recorded only as a current year expense, which cost the system \$11,200 in fiscal 2005 and \$10,500 in fiscal 2004 (see page 49 of the 2005 Financial Report).

The actuarially determined unrecorded liability is \$340,000,000!!!

The administration states on page 45 of the FY 2006 Operating Budget that strategies to reduce this cost are being reviewed, including:

Modify eligibility for meeting age/service threshold

Modify participant cost sharing and contribution structure

Change integration with Medicare

Require contributions from pre-Medicare participants determined on age based premiums

Cap employer contribution as fixed dollar amount or cost level in a future year

This will almost certainly become a major bargaining issue at the University of Maine as at other institutions. Feel free to contact me for some suggestions as to how to address this issue at the bargaining table. It is becoming an issue of major importance at many institutions.

LOOKING TO THE FUTURE

In regards to enrollment projections, management asserted on page 19 of the 2005 Financial Report that the number of Maine high school graduates are projected to decrease and “The System is actively pursuing increased student enrollment and retention at each campus” . See page 19 for a detailed list of recruitment measures.

Looking further to the future, the University of Maine System has the same global financial challenges that most other public higher education institutions face. An annual survey by the College Board reported that public University tuition increased by an average of 10.5% for 2004-05, the second year of double digit growth in a row. American Council on Education

president David Ward commented in the *New York Times* that “ Unless we publicly debate the quiet cost-shifting from state support to tuition that continues in far too many states, no amount of effort by our institutions to raise revenue and cut expenses will be able to preserve affordable tuition formulas, particularly at public colleges and Universities”. For example, states have a financial incentive to spend more on medicaid (for which they get federal matching funds, as I understand the funding process) than to spend money on higher education. The increase in health care costs way beyond the general cost of living increases is a problem that must be addressed nationally. All institutions are being impacted by these health benefit increases. Finding a way to change these global funding realities will have to take place at a higher pay grade than mine.

One final quotation, from Chancellor Westphal in his two page memo concerning the 2005 Financial Report:

“In summary, the strong financial position of the University of Maine System, supported by net assets of \$555 million and substantial liquid cash equivalents and investments on hand will provide stability during these difficult financial times as we complete our facilities and technology infrastructure expansion over the next several bienniums.”

TABLE 6 HEADCOUNT ENROLLMENT AND “REGULAR” EMPLOYEES AT U. OF MAINE

FALL	HEADCOUNT	# EMPLOYEES	# FACULTY
2005		5,300	1,474
2004	34,253	5,281	1,490
2003	34,375	Not Available	Not Available
2002	34,089	Not Available	Not Available
2001	32,955	Not Available	Not Available
2000	32,372	4,462	1,322
1999	31,893	4,312	1,292
1998	30,620	4,154	1,275
1997	30,018	4,147	1,167
1996	30,931	3,984	1,225
1995	31,115	4,179	1,211
1994	31,220	4,122	1,222
1993	31,661	4,130	1,225
1992	32,826	4,120	1,226
1991	33,399	4,193	1,251
1990	34,013	4,438	1,343
1989	33,676	4,942	1,461
1988	31,458	4,755	1,462

1987	29,428	4,534	1,417
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From Fall 1987 to Fall 2004:

Student Headcount Increased 11.6%

TABLE 7 HEADCOUNT ENROLLMENT AND FTE EMPLOYEES AT U. OF MAINE

	FALL HEADCOUNT (STUDENTS)	# FTE EMPLOYEES	FTE FACULTY
2005		4,450	1,580
2004	34,253	4,520	1,583
2003	34,375	4,486	1,630
2002	34,089	4,534	1,641

