

CSU, Chico
Composite Financial Index Analysis
CFI

Prepared by
George Wellman

August 31, 2006

Overall Financial Health -- The Composite Financial Index

Integrating the CFI into the Strategic Plan

The CFI is best used as a component of financial goals in the institution's strategic plan. The institution is best served if the CFI is calculated over an established time period, for example, the past three years, and the next five. This gives a more accurate picture of overall financial health.

Routine financial statement modeling to determine the CFI gives the opportunity for constant functional assessment and continued awareness of institutional performance.

The CFI is established by first creating the value of the four core ratios:

- Primary Reserve Ratio
- Net Income Ratio
- Return on Net Assets Ratio
- Viability Ratio

These ratios compare the institution's operating commitments (Primary Reserve Ratio) and its outstanding long-term obligations (Viability Ratio) against its expendable wealth. They measure the ability of the institution on a short-term basis to live within its means (Net Income Ratio) and the ability of the institution to generate overall return against all net resources (Return on Net Assets Ratio).

Two basic concepts are emphasized in this analysis. First, that a few measures can effectively provide insight to financial health; and second, that the ratios are most useful if the information is readily obtainable and the calculations repeatable.

These four ratios, properly weighted and scored on a common scale, can create a single score of institutional financial health. The use of a single score is superior to individual measurement of each ratio because a single score allows a weakness in a particular ratio to be offset by a strength in another ratio.

The CFI is intended to assist institutions in understanding the affordability of their strategies and to monitor the financial results of the implementation of strategic initiatives. The time horizon for effective ratio analysis is necessarily long term. _1/

_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 10-11, 29.

Composite Financial Index Analysis -- Composite Score Calculation

Scale for Converting Core Ratios to Strength Factors

(Very Little Fin Health) (Relatively Stronger Fin Health) (Strong Fin Health)

(Threshold)_{2/}

Scoring Scale	1	3	10
	<u>Ratio Value</u>		
Primary Reserve Ratio	0.133	0.40	1.33
Net Income Ratio	1.30%	4.00%	13.00%
Return on Net Assets	2.00%	6.00%	20.00%
Viability Ratio	0.417	1.25	4.16

_1/

Weighting Factors

	Institutions with Long-Term Debt
Primary Reserve Ratio	35%
Net Income Ratio	10%
Return on Net Assets	20%
Viability Ratio	35%

_1/

CSU, Chico	Ratio Value	Strength Factor		Weighting Factor	Composite Score
Primary Reserve Ratio	0.45	3.38	x	35%	1.2
Net Income Ratio	6.6%	5.06	x	10%	0.5
Return on Net Assets	9.1%	4.57	x	20%	0.9
Viability Ratio	3.12	7.47	x	35%	2.6
Composite Financial Index					5.2

_1/

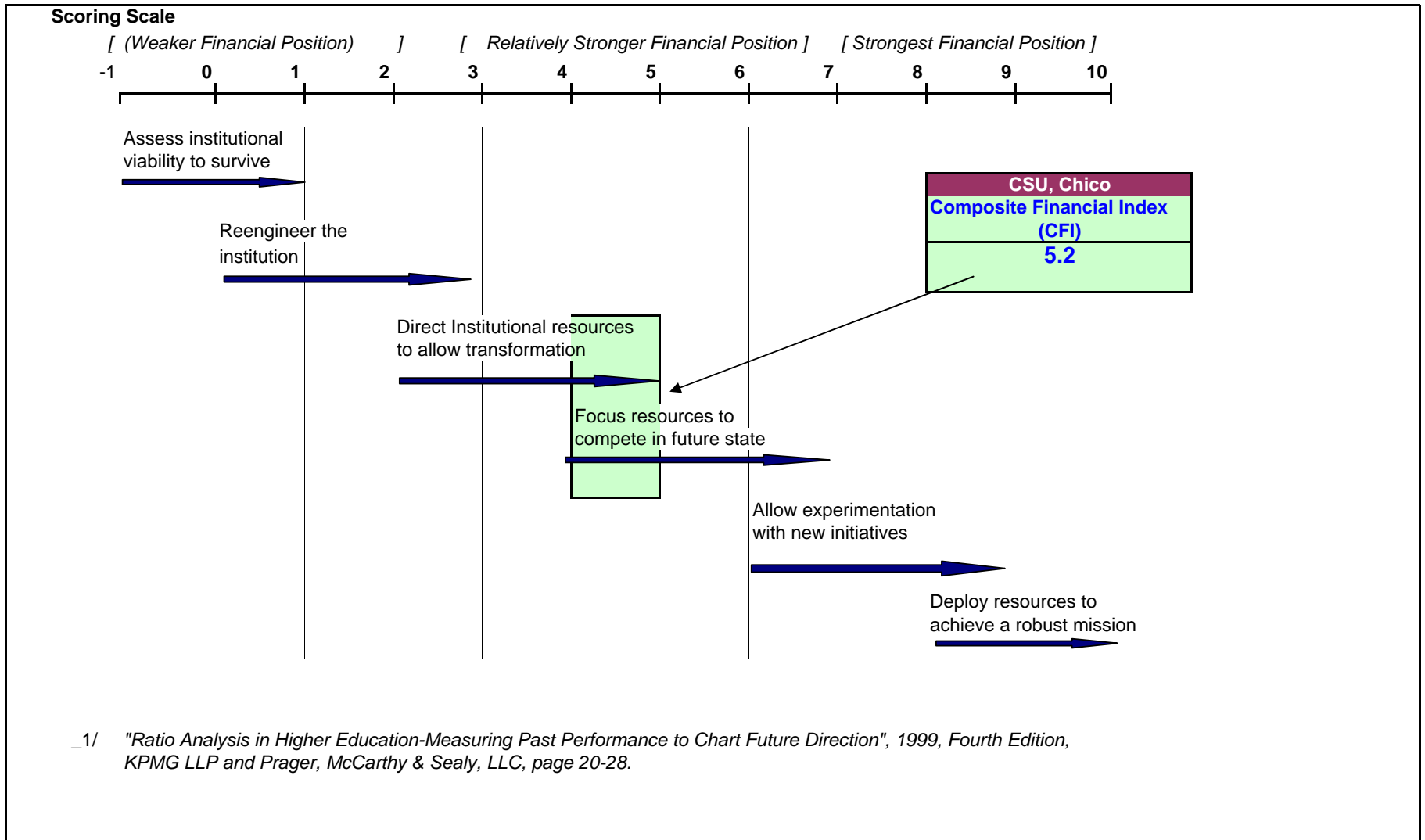
"Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 20-28.

_2/

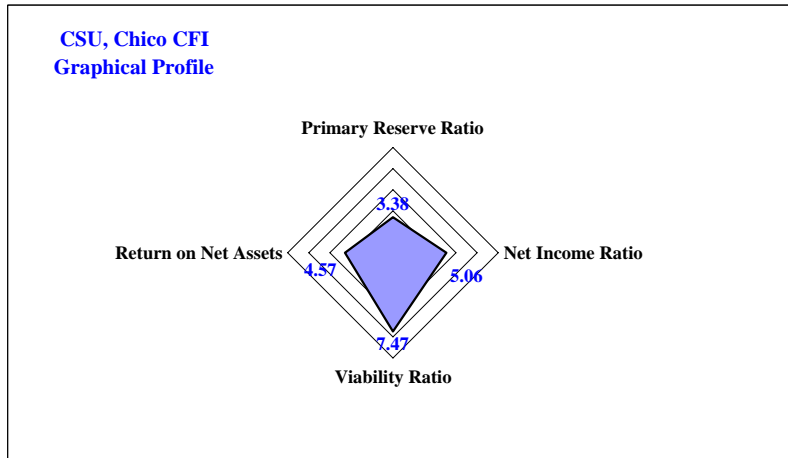
"Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 25-27.

The "Threshold" values represent an assessment based on industry experience since institutions began issuing financial statements under SFAS Nos. 116 and 117 and the concepts of the AICPA Audit and Accounting Guide: Not-for Profit Organizations. A strength factor of 3 on each ratio indicates that the institution is relatively financially healthy; net income is sufficient to keep pace with moderate expense levels; the return on net assets would appear reasonable for the overall investment activity of the institution; and expendable net assets exceed debt levels, although not by excessive amounts.

Scale for Charting Composite Financial Index (CFI) Performance



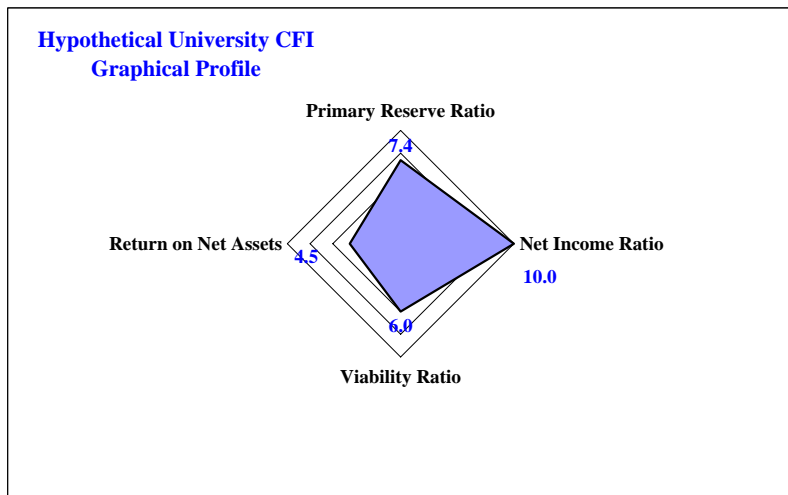
CSU, Chico	
Strength Ratios	
Primary Reserve Ratio	3.38
Net Income Ratio	5.06
Viability Ratio	7.47
Return on Net Assets	4.57



Because there is a correlation between the Primary Reserve Ratio and the Viability Ratio, and correlation between the Return on Net Assets and Net Income Ratio, these ratios are placed opposite each other on the axes. The share of the shaded area can be instructive in assessing high-level financial position. A short vertical axis with an elongated horizontal axis would indicate relatively stronger operating results, but a relatively undercapitalized institution. _1/

In comparison to a hypothetical institution, the following graphical presentation shows a financially strong institution that has produced substantial returns on current activities and there are no perceived weaknesses. _1/

Hypothetical Institution	
Strength Ratios	
Primary Reserve Ratio	7.4
Net Income Ratio	10.0
Viability Ratio	6.0
Return on Net Assets	4.5



_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 30.

Composite Financial Index Analysis -- Primary Reserve Ratio

Description: The Primary Reserve Ratio measures the financial strength of the institution by comparing expendable net assets to total expenses. This ratio provides a snapshot of financial strength and flexibility by indicating how long the institution could function using its expendable reserves without relying on additional net assets generated by operations. _1/

Resource Sufficiency & Flexibility: Are resources sufficient and flexible enough to support the mission?

A Primary Reserve Ratio of .40X or better is advisable to give institutions the flexibility to transform the enterprise. The implication of a .40x ratio is that the institution would have the ability to cover about five months of expenses. Generally institutions operating at this level are able to carry on a reasonable level of activities, and appear capable of managing modest unforeseen adverse financial events. _1/

Formula :
$$\frac{\text{Expendable Net Assets}}{\text{Total Expenses}}$$

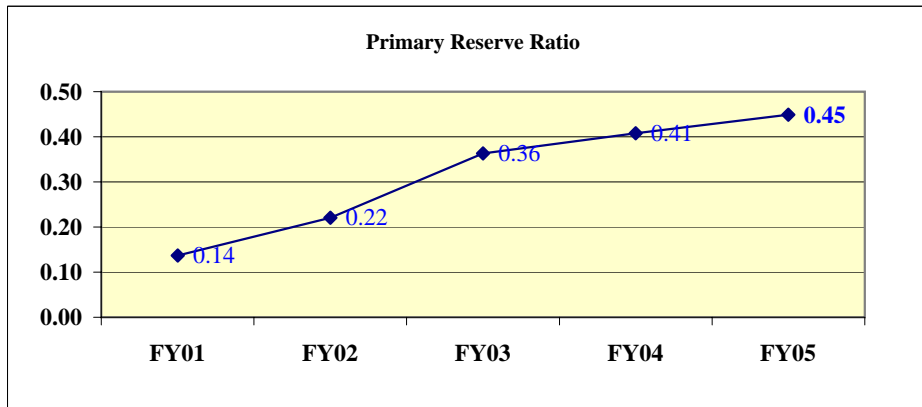
Where:

Expendable Net Assets = Total Net Assets - Restricted Endowments - Investment in Capital Assets

CSU, Chico	FY01	FY02	FY03	FY04	FY05
Primary Reserve Ratio	0.14	0.22	0.36	0.41	0.45

CSU, Chico Data	FY01	FY02	FY03	FY04	FY05
Expendable Net Assets	\$ 32,587,791	\$ 53,249,364	\$ 87,337,635	\$ 100,265,574	\$ 109,948,116
Total Expense	\$ 237,552,310	\$ 241,228,450	\$ 240,668,323	\$ 245,895,688	\$ 244,738,786

Includes Auxiliary Organizations



Financial Accounting Standards suggest a Primary Reserve Ratio of .40x or better is advisable to give institutions the flexibility to transform the enterprise.

Chico's Condition : *Slightly below standard, but trending upward.*

_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 11-13.

Composite Financial Index Analysis -- Net Income Ratio

Description: The Net Income Ratio indicates whether total unrestricted activities resulted in a surplus or deficit, and answers question, "Do operating results indicate the institution is living with available resources?" The ratio is a primary indicator, explaining how the change in unrestricted net assets affects the behavior of the other three core ratios. _1/

Operating Results - Do operating results indicate the institution is living within available resources?

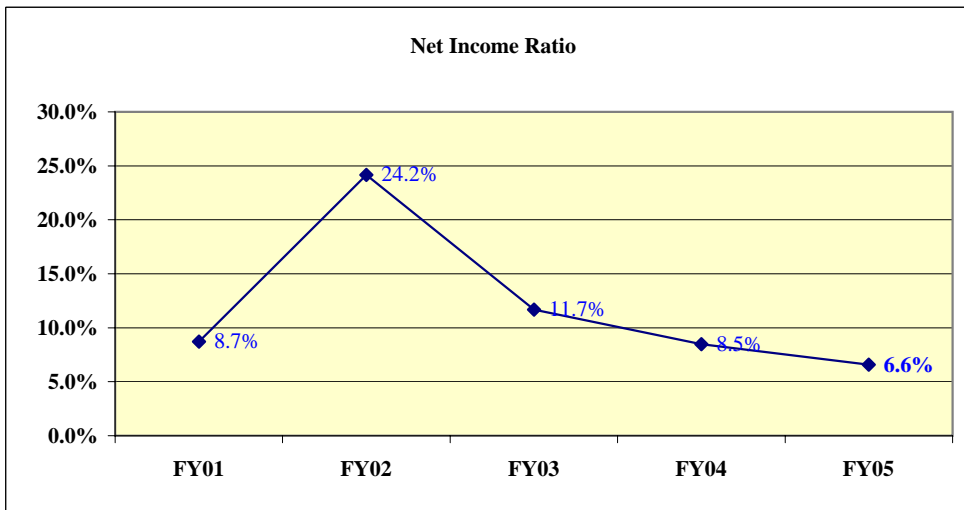
A Net Income Ratio that is positive indicates the institution experienced an operating surplus for the year. Generally speaking, the larger the surplus, the stronger the institution's financial performance. However, if surpluses are obtained by under spending on mission-critical investments, the surplus should be questioned. A negative ratio indicates a loss for the year. _1/

Formula :
$$\frac{\text{Change in Unrestricted Net Assets}}{\text{Total Unrestricted Income}}$$

CSU, Chico	FY01	FY02	FY03	FY04	FY05
Net Income Ratio	8.7%	24.2%	11.7%	8.5%	6.6%

CSU, Chico Data	FY01	FY02	FY03	FY04	FY05
Change In Unrestricted Net Assets	\$ 4,649,928	\$ 12,647,161	\$ 6,985,760	\$ 5,580,569	\$ 4,272,073
Total Unrestricted Income	\$ 53,284,252	\$ 52,333,718	\$ 59,755,696	\$ 65,873,189	\$ 64,887,833

Includes Auxiliary Organizations



A positive ratio indicates the institution experienced a operating surplus. Generally the larger the ratio (surplus) the better. However, if surpluses are obtained by under spending on mission-critical investments, excessive surpluses should be questioned.

Chico's Condition : Strong position within normal variances over time.

_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 14-16.

Composite Financial Index Analysis -- Return on Net Assets

Description: The Return on Net Assets Ratio is a measure of whether or not the institution's resources are growing. This ratio, like all the ratios, is better applied over an extended period so that results of long-term plans are measured. Long-term returns are quite volatile and vary significantly based on the prevailing level of inflation. Therefore, establishing fixed nominal return targets is not possible. Rather, institutions should establish a real rate of return target in the range of 2-3%. _1/

Financial Asset Performance - Does financial asset performance support the strategic direction?

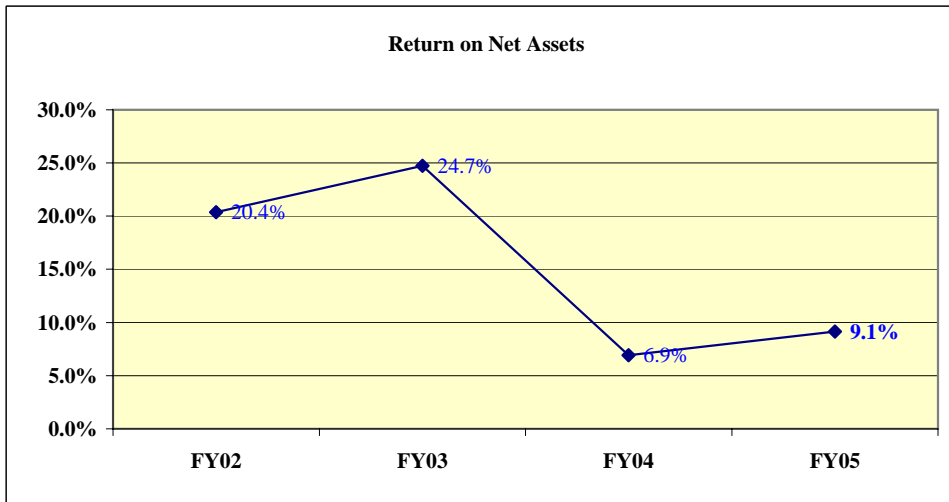
A Return on Net Asset Ratio determines whether the institution is financially better off than in previous years by measuring total economic return. A decline in this ratio may be appropriate and even warranted if it reflects a strategy to better fulfill the institution's mission. An improving trend in 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. _1/

Formula :
$$\frac{\text{Change in Net Assets}}{\text{Total Net Assets}}$$

CSU, Chico	FY01	FY02	FY03	FY04	FY05
Return on Net Assets	2.0%	20.4%	24.7%	6.9%	9.1%

CSU, Chico Data	FY01	FY02	FY03	FY04	FY05
Change in Net Assets	\$ 2,753,567	\$ 28,571,537	\$ 41,771,647	\$ 14,572,857	\$ 20,574,083
Total Net Assets (beginning of year)	\$ 137,586,412	\$ 140,339,979	\$ 168,911,516	\$ 210,683,163	\$ 225,256,020

Includes Auxiliary Organizations



A positive ratio indicates a favorable return on total economic activity that provides resources to fulfill the institution's mission.

Chico's Condition : Strong returns at a high nominal rate of return. A standard rate of return, adjusted for inflation (real return) is more typically in the 3-6% range. Chico's condition shown here is at the nominal rate, unadjusted for inflation.

_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 17-21.

Composite Financial Index Analysis

Description: The Viability Ratio is a measure of whether or not the institution has sufficient Net Assets to pay off long-term debt.

Debt Management - Is debt managed strategically to advance the mission?

A *Viability Ratio* measures one of the most basic determinants of clear financial health: the availability of expendable net assets to cover debt should the institution need to settle its obligations as of the balance sheet date. A ratio in the range of 1.25x to 2.0x indicates a strong creditworthy institution. However, the level that is "right" is institution-specific. The institution should develop a target for this ratio that balances its financial, operating, and programmatic objectives. _1/

Formula :
$$\frac{\text{Expendable Net Assets}}{\text{Long-Term Debt}}$$

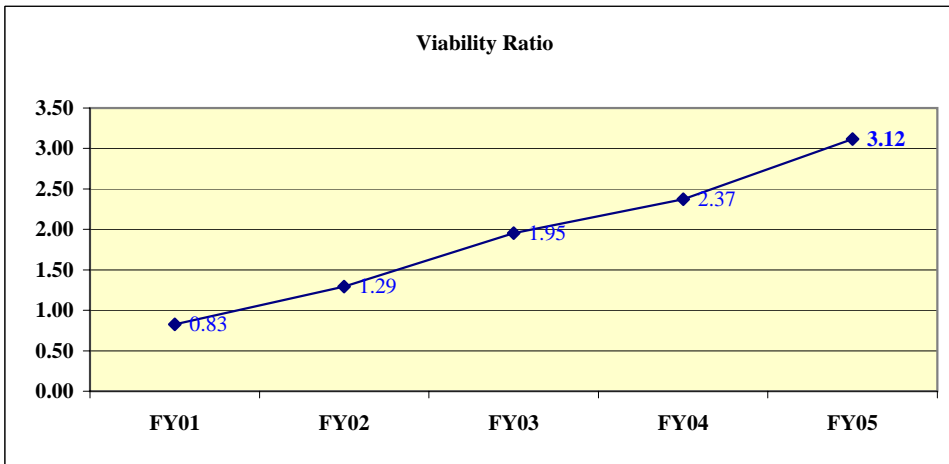
Where:

Expendable Net Assets = Total Net Assets - Restricted Endowments - Investment in Capital Assets

CSU, Chico	FY01	FY02	FY03	FY04	FY05
Viability Ratio	0.83	1.29	1.95	2.37	3.12

CSU, Chico Data	FY01	FY02	FY03	FY04	FY05
Expendable Net Assets	\$ 32,587,791	\$ 53,249,364	\$ 87,337,635	\$ 100,265,574	\$ 109,948,116
Long-Term Debt	\$ 39,451,828	\$ 41,177,638	\$ 44,748,597	\$ 42,223,358	\$ 35,295,787

Includes Auxiliary Organizations



A positive ratio indicates to what degree net assets are available to cover long-term debt. A ratio of 1:1 or greater indicates sufficient expendable net assets to satisfy debt obligations.

Chico's Condition : Upwardly trending positive ratio within established and typically reported standards.

_1/ "Ratio Analysis in Higher Education-Measuring Past Performance to Chart Future Direction", 1999, Fourth Edition, KPMG LLP and Prager, McCarthy & Sealy, LLC, page 21-23.