

An Update Analysis of the Financial Statements

of

**The University of Delaware
Academic Years 2004-2011**

Prepared for AAUP

By

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Introduction

This report updates my previous report, which covered the years 2004-2009. Due to space limitations the tables in this update will for the most part have data covering the years 2006-2011. However, the graphs will cover the entire period from 2004-2011. The supporting data for the years 2004-2006 can be obtained by looking at my original report.

Most businesses have a goal of earning profit for stockholders. Thus, the financial statements of most businesses are designed to allow stockholders and others concerned with profitability a means to monitor the performance of the business in question.

Universities and other non-profit organizations ostensibly have an entirely different purpose. Universities, in particular, are institutions of higher learning established primarily to create and disseminate knowledge. Universities receive a significant portion of their funding from donors and governmental entities. These funds are often given with certain restrictions and conditions. Consequently, universities use a system of fund accounting. The primary purpose of fund accounting is to provide trustees, who are legally responsible for running universities, the information to monitor the funds that come into the institution and ensure that they are expended for their intended purpose.

Since the primary purpose of fund accounting is to ensure that funds provided by governmental entities or donors are expended in the manner they were intended, it is difficult for faculty to look at a university's financial statements and get a true picture of the university's financial health. In the past, financial statements for universities were broken down into various fund groups. In effect each fund group had its own financial statements and universities could move money between funds making it difficult to understand whether universities had revenues in excess of expenses or whether expenses exceeded revenues. In 2002 public universities changed their financial statements so that they more closely resemble those of for-profit businesses. One might argue that this new reporting format is a reflection of the growing corporatization of universities, which are increasingly being run more and more like for-profit enterprises. However, one of the benefits of the new reporting format is that it is now easier for faculty to understand the financial status of their institutions.

Historically, most universities have had some sort of a faculty budget oversight committee as part of their faculty governance structure. Many of the functions of these budget oversight committees have been taken over by collective bargaining agents at institutions where faculty members have opted to engage in collective bargaining. However, whether an institution has collective bargaining or a traditional budget oversight committee, faculty at most institutions focus on the annual budget of the institution.

Often, looking only at a university's budget misleads faculty members. Budgets are normally based only on the current fund and since universities have the ability to transfer money from one fund to another looking at the current fund does not give a true

picture of a university's finances. In addition, a budget is just a financial plan. However, institutions have no legal obligation to spend money in accordance with their budget.

For example, a budget may show that money has been allocated for a certain number of faculty positions. However, in any given year a certain number of faculty members leave institutions either to take jobs elsewhere or to retire. Consequently, in any given year a certain number of positions that are budgeted are vacant. Therefore, what a university budgets for faculty salaries and benefits is not necessarily what they actually spend on salaries and benefits. Consequently, some percentage of budgeted positions either gets spent elsewhere or accumulates and becomes part of the university's net assets.

To get a true picture of a university's finances one must look at the actual financial statements, which represent the actual revenues and expenses of the university. Evaluating a university's finances by looking at its budget would be the equivalent of evaluating the performance of a for-profit company by looking at its business plan.

In a for-profit business, revenues come into the business through the sale of goods and/or services. In the process of producing goods and services firms incur costs. The difference between revenues and costs represents the firm's profit or loss. This profit or loss is one of the primary indicators of how the firm is performing. Non-profit organizations such as universities take in revenue in the form of tuition dollars, donations and governmental support. In the process of carrying out the mission of their institution universities incur expenses. The difference between the revenues that come into a university and its expenses is known as a change in net assets. If a university takes in more revenue than it expends there is a positive increase in net assets. Conversely, if the expenses exceed the revenues there is a decrease in net assets. Increases or decreases in net assets are one of the prime indicators of how a university is performing financially.

Beginning in 2002, public universities were required to make some important changes in the way they reported on their financial status due to the implementation of GASB 34 & 35. For example, previously when revenues exceeded expenditures there was an increase in fund balances. Since 2002 the term change in fund balance has been replaced by change in net assets. The purpose of the change in financial reporting was to make college and university financial statement easier to understand and to provide management with better information to manage universities as business entities. Since this report covers the period from 2004-2009 and all of the data used in this report is compatible with the new format.

Financial data is reported either as a stock or flow. A stock means measurement takes place in dollars without respect to time. For example, the amount of money in your savings account is a stock. Flows are measurements that have a time dimension. For example, income is a flow because it is measured as a certain number of dollars per year.

Universities have three main financial statements. First there is a balance sheet, a statement of net assets, or a statement of financial position. Balance sheets have three

main components: assets, liabilities and net assets. Assets are things of value owned by the university. Liabilities are claims against the university and net assets are the difference between assets and liabilities. Net assets represent the wealth of the institution. All of the items on a balance sheet deal with stock concepts and represent a snapshot of the university at a point in time. Thus, the first part of this report will provide an analysis of the University's balance sheet.

The second major financial statement is an income statement, statement of revenues, expenses and changes in net assets, or a statement of activities. This financial statement shows how the university's finances are changing over a period of time, namely a fiscal year, which normally runs from July 1 to June 30 of the following year. Fiscal years are always associated with the calendar year in which the fiscal year ends. So for example, from July 1, 2008 to June 30, 2009 is known as fiscal year 2009. This statement deals with flows and measures how the university's revenues and expenses are changing over time.

There is a certain consistency or relationship between stocks and flows or between the balance sheet and the income statement. For example, if revenues are greater than expenses then there will be an increase in net assets. This means that if you take the net assets at the beginning of a year on the balance sheet and add the change in net assets from the statement of statement of activities you will get the net assets reported at the end of the year. The second part of this report will provide an analysis of the University's statement of activities.

The third financial statement is the statement of cash flows. Universities use a system of accrual accounting, which means they book revenues when they earn them and book expenses when they are incurred. However, recognizing revenue is not always the same as collecting cash. For example, a university may send a bill to a student for tuition but not immediately collect the money that is owed. This transaction shows up on the universities balance sheet as an increase in accounts receivable and is booked on the statement of revenues, expenses and changes in net assets as revenue. While the university shows an increase in revenue it does not actually have more cash. Hence the role of the cash flow statement is to show the inflows and outflows of cash. The third section of this report will provide an analysis of the University's cash flow statement.

Most public universities follow standards for reporting financial data established by the Governmental Accounting Standards Board (GASB). Private non-profit Accounting Standards Board (FASB). The University of Delaware is extremely unusual in its financial reporting because, although it is a public university, it uses FASB reporting standards. GASB standards for public universities require the disclosure of more information. For example, they require universities to report current and non-current assets and current and non-current liabilities. FASB standards do not require that any distinction be made between current assets and non-current assets or current liabilities and non-current liabilities. Perhaps the biggest difference is that GASB requires a Management Discussion and Analysis (MDA), which reviews the major financial

statements and gives management's perspective on how the university is doing with respect to its financial health. This is absent when using FASB standards for non-profits.

In providing an analysis of each of these financial statements it is important to look at trends such as the increase or decrease in net assets. In addition, this report will also calculate certain ratios, which are indicators of financial performance. These ratios can be used to look at the historical performance of the institution. Furthermore, these ratios can also be used to compare one institution to another institution, or to certain standards that have been established in the field of higher education. However, caution should be exercised when comparing one institution to another because of differences in reporting.

Finally, over time the University has become less transparent in its reporting of data, particularly data on net assets. Before 2009 the University used to give a detailed breakdown of net assets allowing us to separate investment in plant and equipment from other unrestricted net assets. Unfortunately, starting in 2009 the University discontinued this breakdown so that the only way to separate investment in plant and equipment from other unrestricted net assets is to estimate the value of investment in plant and equipment using accounting definitions and subtract this estimate from unrestricted net assets.

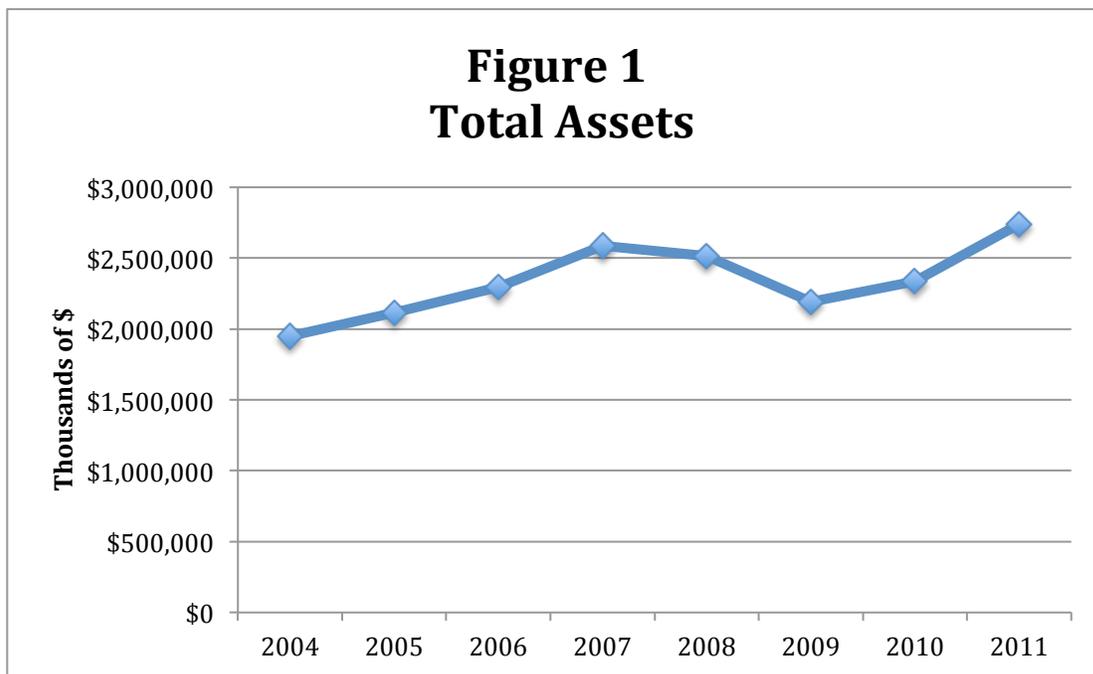
It is also important to note that the University reclassified a large portion of unrestricted net assets as being temporarily restricted in 2008. This was a change in classification of net assets based on the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The reclassification has to do with how net appreciation of donor-restricted net assets is treated. Before, 2008 the University treated the appreciation of these net assets as unrestricted. However, following the recommendation of UPMIFA these net assets are now treated as temporarily restricted net assets until they are appropriated by the University at which time, assuming there are no other restrictions, they become unrestricted net assets. This change reduced unrestricted net assets in 2008 by \$494 million and increased temporarily restricted net assets by a like amount. This is purely an accounting change and did not affect the financial health of the institution in anyway. In this report, when discussing unrestricted net assets we will adjust for this change so that we can follow changes in trends in various types of net assets, although we will also show the unadjusted data as well.

The purpose of this report is to help educate faculty of The University of Delaware about the financial status of their university. The information provided in this report is provided solely for educational purposes. Every effort has been made to ensure that the information in this report is accurate. Any errors or misstatements are purely unintentional and the author accepts no responsibility for any damage that may result.

What is the Wealth of the University?

Assets and Liabilities

An asset is something that an institution owns that is expected to provide a benefit in the future. Assets can be divided into two classes: real assets such as classrooms, laboratories, computers, library books and journals etc., and financial assets such as cash that can be used to make student loans and finance current operations, and investments in financial instruments such as endowments, which can be used to generate income to defray certain expenses or be liquidated during a period of a financial crisis. Liabilities are claims on an institution's resources. Figure 1 and Table 1 show the total assets of the University. Total assets are reported net of accumulated depreciation.



Between 2004 and 2007 the total value of assets increased from \$2.0 billion to \$2.6 billion. From 2007 through 2009 the value of total assets decreased by approximately \$400 million ending up at \$2.2 billion. Most of the decline in total assets in 2008 and 2009 was due to declines in endowment funds and other investments. In 2010 and again in 2011 there was a sharp rise in total assets with endowment funds surpassing their previous peak in 2008.

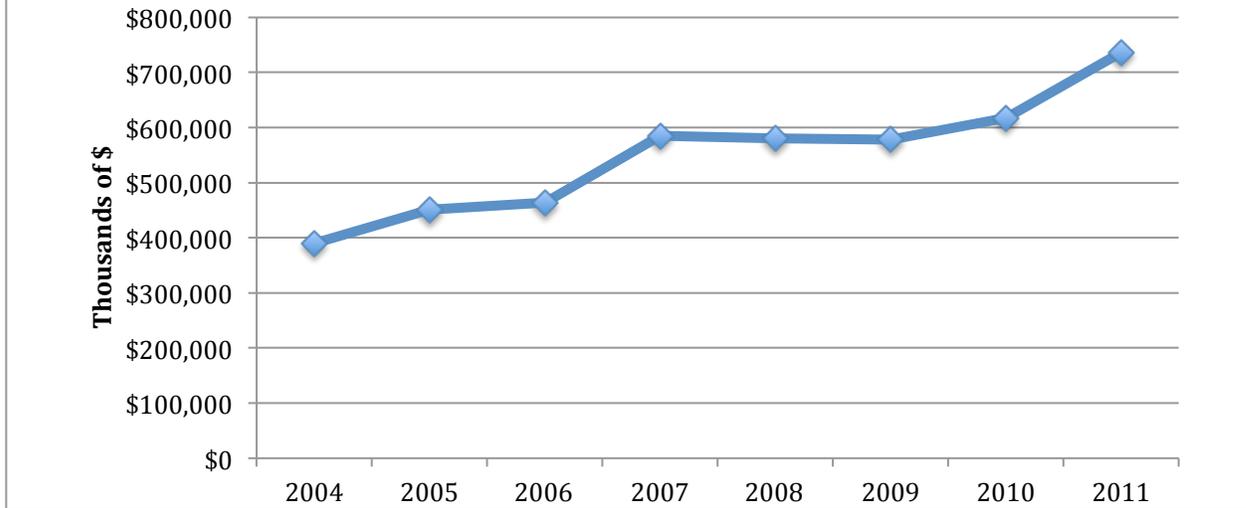
Generally, a university's assets can be divided into current and non-current assets. Current assets consist of assets that will be used up during the course of a year. The major items that comprise current assets are cash and cash equivalents, accounts receivable, inventories, deposits and prepaid expenses. Non-current assets are tangible assets that will last longer than a year or financial assets that will be held more than a year. The

major items in this category are investments, endowment and capital assets along with some receivables.

Table 1 Statement of Financial Position For the year ending June 30 Thousands of \$						
	2006	2007	2008	2009	2010	2011
Assets:						
Cash and cash equiv.	\$22,922	\$46,114	\$39,350	\$55,315	\$34,094	\$40,677
Restricted cash and cash equivalents	\$18,133	\$20,686	\$19,987	\$20,463	\$18,192	\$111,984
Securities lending collateral	\$40,614	\$47,471	\$14,689	\$15,614		
Interest rate swap asset		\$1,078				
Accounts and notes receivable	\$36,111	\$33,371	\$33,415	\$30,988	\$41,964	\$49,913
Prepaid expenses and inventories	\$728	\$1,161	\$1,494	\$1,633	\$3,326	\$4,708
Contributions receivable, net	\$8,247	\$6,105	\$4,350	\$5,090	\$15,345	\$22,041
Student loans receivable	\$14,226	\$14,057	\$15,322	\$14,977	\$15,377	\$14,719
Endowment funds and other investments	\$1,251,539	\$1,469,954	\$1,377,805	\$1,053,419	\$1,175,474	\$1,358,000
Annuity and life income	\$12,779	\$13,617	\$11,394	\$8,576	\$8,572	\$8,629
Funds held in trust	\$66,359	\$75,497	\$71,222	\$50,871	\$54,021	\$60,566
Property, plant and equipment, net of depreciation	\$821,930	\$855,620	\$925,358	\$935,388	\$970,974	\$1,067,858
Total Assets	\$2,293,588	\$2,584,731	\$2,514,386	\$2,192,334	\$2,337,339	\$2,739,095

Most of the University's assets are non-current assets. The two largest components of non-current assets are endowment funds and other investments and property, plant and equipment, net of accumulated depreciation. There has been a fairly steady increase in property plant and equipment which increased from \$666.3 million in 2004 to \$935.4 million in 2009, an increase of 40%. By 2011, the value of property plant and equipment, net of depreciation increased to \$1.1 billion, an increase of 14% since 2009. Endowment funds and other investments increased from \$1 billion in 2004 to \$1.5 billion in 2007. In 2008 endowment funds and other investments declined to \$1.4 billion and then to \$1.05 billion in 2009.

**Figure 2
Total Liabilities**



**Table 2
Liabilities & Net Assets
For the year ending June 30
Thousands of \$**

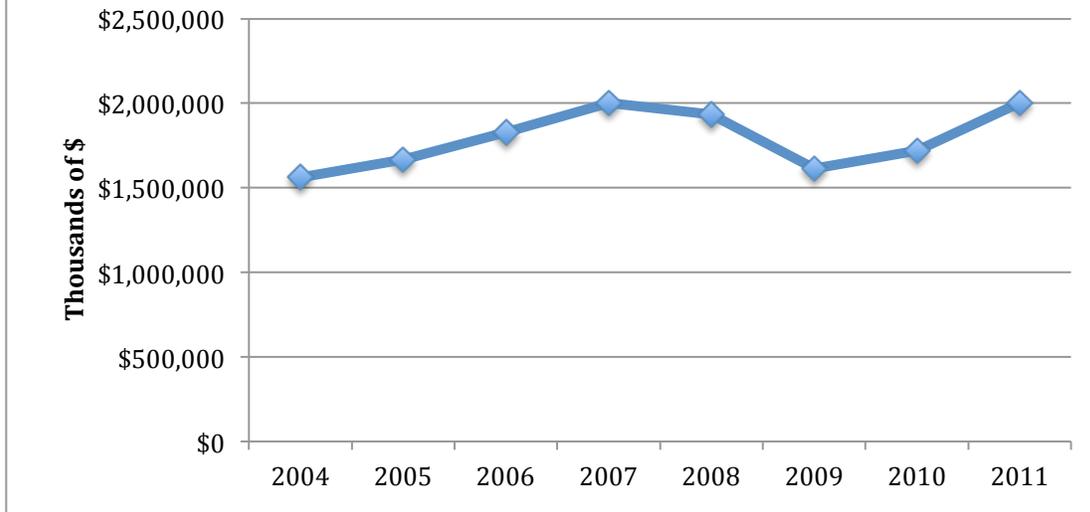
	2006	2007	2008	2009	2010	2011
Accounts payable and accrued liabilities	\$53,058	\$52,903	\$59,179	\$44,340	\$53,677	\$71,799
Securities lending collateral payable	\$40,614	\$47,471	\$14,689	\$15,614		
Deferred revenues and student deposits	\$7,161	\$7,618	\$7,841	\$8,491	\$8,140	\$9,099
Obligations under capital leases	\$9,419	\$9,002	\$8,565	\$8,103	\$7,616	\$7,099
Notes and bonds payable	\$190,368	\$257,113	\$250,531	\$241,415	\$243,750	\$363,948
Interest rate swap liability	\$75		\$12,758	\$26,138	\$26,118	\$21,434
Annuity and life income funds payable	\$5,768	\$5,954	\$5,819	\$5,385	\$4,959	\$4,721
Compensated absences payable	\$10,914	\$11,253	\$11,969	\$12,555	\$12,987	\$13,434
Postretirement benefit obligation	\$127,515	\$171,432	\$183,991	\$189,070	\$227,509	\$209,491
Advances from federal government for student loans	\$14,077	\$14,243	\$14,465	\$14,725	\$14,807	\$14,903
Asset retirement obligation	\$4,440	\$7,533	\$10,505	\$11,761	\$18,136	\$20,185
Total Liabilities	\$463,409	\$584,522	\$580,312	\$577,597	\$617,699	\$736,113
Unrestricted	\$1,420,511	\$1,541,474	\$1,031,166	\$910,676	\$958,025	\$1,115,786
Unrestricted First State Mar.						\$1,307
Temporarily restricted	\$122,034	\$152,997	\$593,322	\$410,205	\$454,692	\$566,294
Permanently restricted	\$287,634	\$305,738	\$309,586	\$293,856	\$306,923	\$319,595
Total Net Assets	\$1,830,179	\$2,000,209	\$1,934,074	\$1,614,737	\$1,719,640	\$2,002,982

In my previous report I predicted that endowment funds would recover substantially and in fact, by 2011, endowment and other investments have largely recovered increasing to \$1.4 billion, still about \$100 million below their peak level in 2007. In the first six months of FY 2012 the stock market has been very volatile declining sharply between July and October 2011 and then recovering most of the losses between October and December. Going forward there is a great deal of uncertainty in financial markets due largely to the European debt crisis. The U.S. economic is continuing a slow jobless recovery and if the European debt crisis is resolved it is likely that the remaining 6 months in the fiscal year will be quite robust. However, if the European debt crisis is unresolved then there could be another sharp downturn in financial markets. Therefore, it is hard to predict what will happen to the University's endowment and investment over the remainder of the fiscal year.

Figure 2 and Table 2 show the total liabilities of the University. Total liabilities increased from \$390 million in 2004 to \$585 million in 2007 before declining to \$577 million in 2009. Most of the increase in total liabilities was due to an increase in non-current liabilities. Specifically bonds and notes payable increased from \$159 million in 2004 to \$257 million in 2007. In 2008 notes and bonds payable decreased to \$250.5 million and then declined again in 2009 to \$241.4 million. Another reason for the increase in total liabilities, particularly between 2004 and 2007, has been the increase in postretirement benefit obligations, which increased from \$96.8 million to \$171.4 million in 2007. Since 2007 the increase in this liability has slowed considerably increasing to \$184 million in 2008 and \$189 million in 2009. Postretirement benefit obligations, account for roughly 32 % of the University's total liabilities. In 2010 and 2011, liabilities rose sharply. In 2010 there was a large increase in post-retirement benefit liabilities, which rose from \$189 million to \$227.5 million before declining to \$209.5 million in 2011. By far the biggest reason for the increase in liabilities was the rise in debt. Debt at the University had been declining since 2007. It rose modestly in 2010 but in 2011 it jumped from \$243.7 million to \$363.9 million, an increase of nearly 50%.

Net assets are the difference between assets and liabilities and represent the wealth of an institution. The net assets of the University are also shown in Table 2 and in Figure 3. In the past, these net assets were referred to as fund balances. Net assets increased from \$1.8 billion in 2004 to nearly \$2 billion in 2007, and then declined modestly in 2008 and more substantially in 2009 ending up at \$1.6 billion by the end of FY 2009. In 2010 net assets increased to \$1.7 billion and jumped to \$2 billion slightly surpassing the previous peak reached in FY 2007.

**Figure 3
Total Net Assets**



An increase in net assets means the University has increased its wealth and conversely a decrease in net assets implies that the University's wealth has decreased. An increase in a university's net assets occurs when revenues exceed expenses. An increase in net assets also occurs when a university receives funding from the state to finance capital projects, when it receives private funding for capital projects, and when it receives contributions to its permanent endowment.

Wealth can be divided into two categories: financial wealth or tangible wealth. Tangible wealth consists of the physical assets of an institution net of the debt owed on those assets. In addition, universities often receive funds that are restricted either by donors or government to be used to purchase tangible assets including construction and renovation of buildings. These restricted funds cannot be used for operating expenses, e.g., paying for salaries and benefits. However, not all funds used for the purchase of tangible assets are restricted. In many cases, universities accumulate funds by running an operating surplus and then choose to use these funds to purchase tangible assets. These are unrestricted funds and they can be used to pay salaries and benefits. Thus, it is important to distinguish between the various types of net assets.

If an increase in total net assets is exclusively due to increases in the value of land, buildings and equipment, the increase in wealth while real, does not give the university added flexibility with respect to operations. To the extent that a university uses funds it generates through operations to purchase land, building and equipment it can decide to reallocate these funds for alternative uses. However, to the extent that it uses capital funds from the state or from private sources for purchases of land, buildings and equipment it is limited and cannot reallocate that money for other purposes. Also once universities purchase land and put up buildings they are unlikely to sell these assets to generate funds, which could be used for other purposes. In addition, it should be noted

that when buildings are constructed using capital funds, there are clear implications for operating expenses in the future. As universities increase their square footage they may also be required to spend additional funds on maintenance and utilities, thereby increasing their operating expenses.

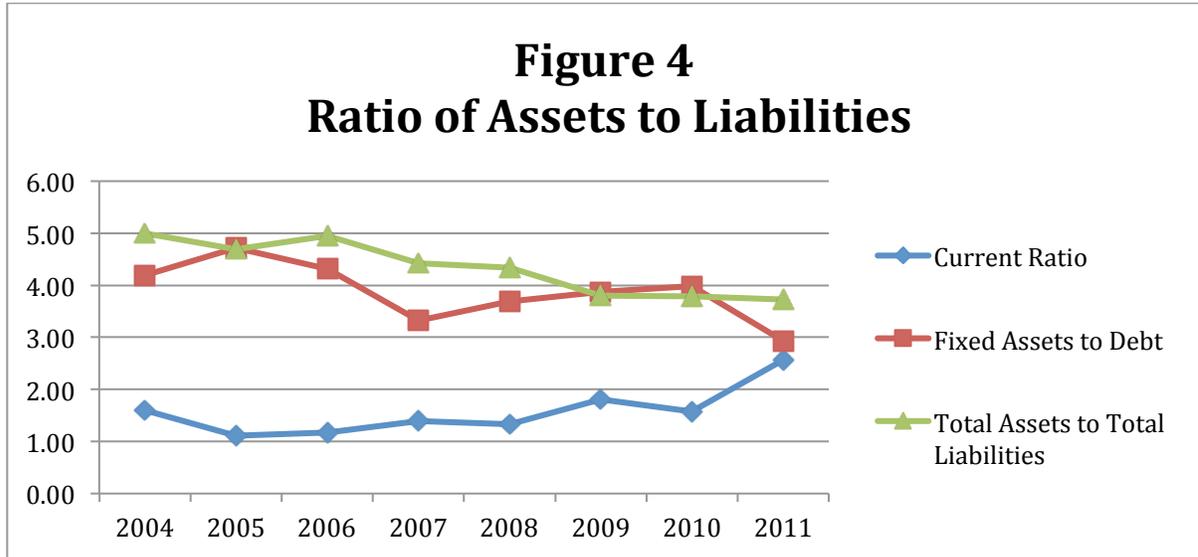
Table 3 Asset to Liability Ratios For the Year Ending June 30						
	2006	2007	2008	2009	2010	2011
Current Ratio	1.18	1.39	1.33	1.81	1.58	2.56
Fixed Assets to Debt	4.32	3.33	3.69	3.87	3.98	2.93
Total Assets to Total Liabilities	4.95	4.42	4.33	3.80	3.78	3.72

Figure 4 shows several key ratios for the years 2004-2011. These key ratios are also reported in Table 3. First is the ratio of current assets to current liabilities. Since the University of Delaware uses FASB reporting standard current assets are not reported. The University does, however, report in graphical form, estimates of the current ratio on the website for the Vice President for Finance for the years 2004-2008. Presumably the University has this information but by using FASB chooses not to share it with the public by including it in its audited financial statements. We provide estimates of current assets and current liabilities to estimate a current ratio for the University. Although our estimates of current assets and current liabilities may not be totally accurate the ratios closely replicates the ratios shown in graphical form.

We estimate current assets by taking the sum of cash and cash equivalents, securities lending collateral, interest rate swap assets, accounts and notes receivable, and prepaid expenses and inventories. Current liabilities include all liabilities payable within one year. Current liabilities are estimated by taking the sum of accounts payable and accrued liabilities, securities lending collateral payable and deferred revenue and student deposits.

The ratio of current assets to current liabilities has varied within a normal range 2004 and 2009. In 2004 the current ratio was approximately 1.6. It fell in 2005 to 1.11 and then rose to 1.18 in 2006 and then to 1.39 in 2007. In 2008 the current ratio fell to 1.33 and then rose to 1.81 in 2009. A current ratio of less than one means that a university does not have enough current assets to cover its current liabilities. In 2009 the University only had enough current assets to cover about 181% of its current liabilities. In 2010 the ratio was 1.58 and then jumped to 2.56 in 2011. Normally this ratio is greater than 1 and less than 2.5, so it is safe to conclude that the University's current ratio is at the high end of the normal range.

Figure 4 also shows the ratio of total assets to total liabilities. From 2006 to 2009 there was a modest decline in the ratio. However, even after the decline the ratio is still fairly high. Since 2009 the ratio has been stable.



Another indicator of financial health is the ratio of fixed assets to long-term debt, which is again shown in Figure 4. Between 2005 and 2007 the ratio declined. Then between 2007 and 2010 there was a modest rise in the ratio. In 2011, the ratio declined to 2.93, its lowest level over the period 2004-2011. Despite this most recent the ratios of fixed assets to debt as well as the ratio of total assets to total liabilities are both fairly high.

Table 4 shows the fair market value of investments for the University of Delaware. Figure 5 also shows the fair market value of total investments from 2004-2011.

As can be seen in Figure 5, the University's investments increased substantially from 2004 to 2007. In 2004 investments were \$1.1 billion and they increased to \$1.6 billion by 2007, an increase of about 40%. In 2008 and 2009 the value of the University's investments declined hitting \$1.1 billion in 2009. This decline is not too surprising given the turmoil in financial markets in 2008 and 2009. It appears that the stock market bottomed out in the summer of 2009 and since then has risen sharply. In my previous report I stated that since the fiscal year ends June 30 it is reasonable to expect that the University would have recovered a substantial portion of the losses in investments in 2010. There was an upswing in the value of the University's investment and this upward trend continued into 2011. It should also be noted that about one-third of the University's investment portfolio is held in Level 3 assets that are very risky and the value of these assets is based on unobservable inputs and does not reflect market activity.

Table 4						
Investments						
For the year ending June 30						
Thousands of \$						
	2006	2007	2008	2009	2010	2011
U.S. government obligations	\$149,911	\$139,383	\$114,300	\$158,452	\$127,172	\$98,792
Corporate obligations	\$73,559	\$172,316	\$151,793	\$97,460	\$136,664	\$167,217
Stock and convertible securities	\$367,310	\$352,127	\$291,160	\$207,963	\$141,067	\$159,222
University mortgages	\$8,662	\$9,186				
International investments	\$255,329	\$291,215	\$272,442	\$180,051	\$78,803	\$92,077
Money market and other liquid funds	\$46,361	\$46,124	\$48,998	\$8,080	\$27,689	\$11,851
Limited partnerships	\$278,966	\$373,112	\$442,333	\$355,524	\$556,172	\$709,305
Inflation sensitive assets					\$49,230	\$64,707
Stock futures fund	\$96,253	\$102,567	\$54,594	\$35,064	\$23,189	\$30,534
Real estate investment trust					\$21,349	\$22,781
Other	\$54,326	\$73,038	\$13,579	\$19,401	\$22,711	\$10,143
Total	\$1,330,677	\$1,559,068	\$1,389,199	\$1,061,995	\$1,184,046	\$1,366,629

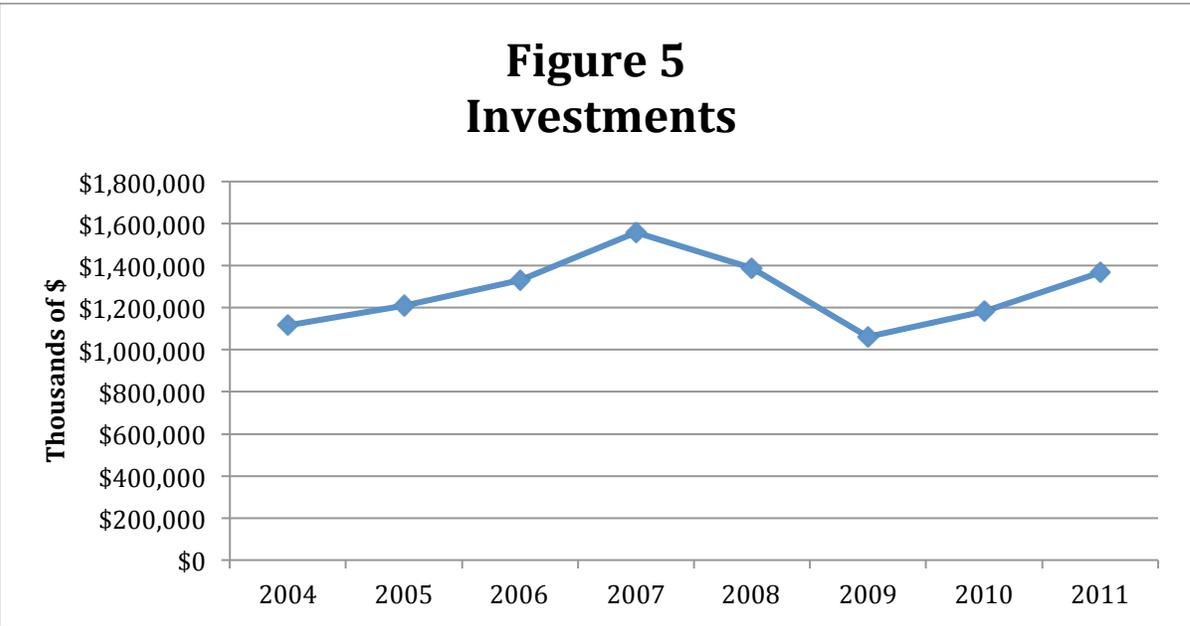


Figure 6 shows the major capital expenditures undertaken by the University of Delaware in the years 2004-2011. These figures come from the Cash Flow statements. Over an eight-year period the University spent a total of \$786.1 million for the purchase of capital assets.

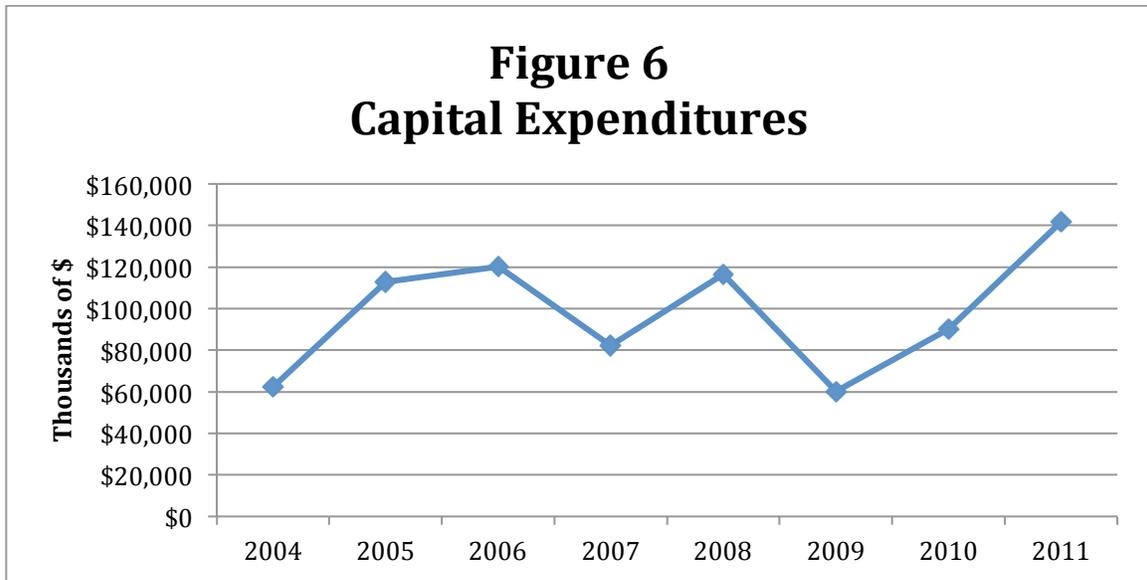
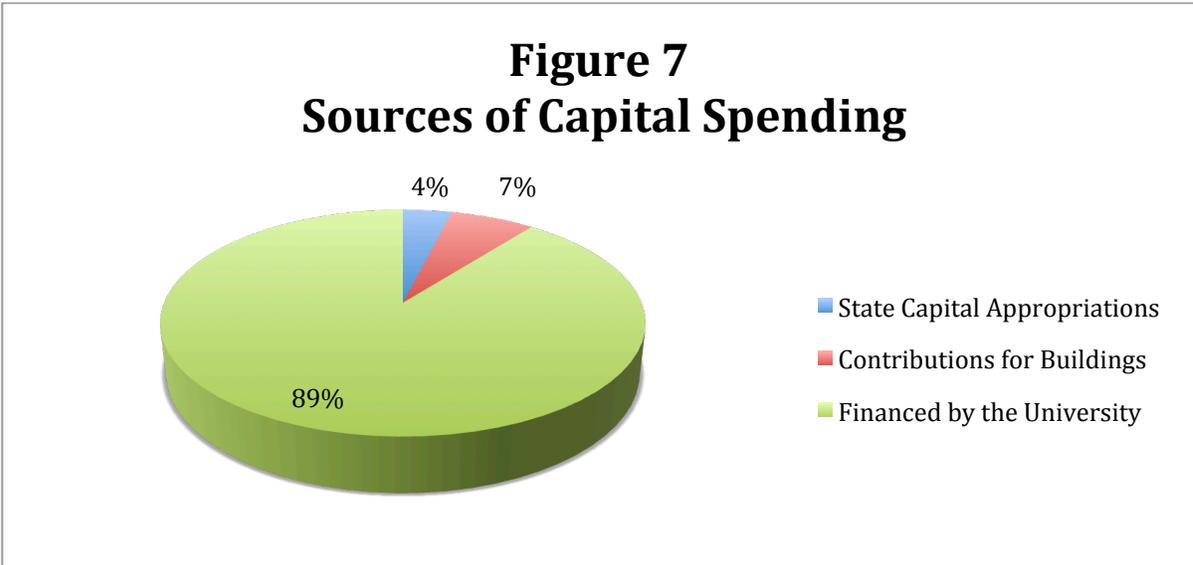


Table 5 shows the value of the capital assets of the University. In 2004 the total value of property, plant and equipment net of accumulated depreciation was \$666.3 million. By 2009 the value of property, plant and equipment increased to approximately \$935.4 million, an increase of 40.4%. Since 2009 the value of property, plant and equipment increased to \$1.1 billion an increase of 14.1%.

The University financed its capital expenditures using a combination of capital appropriations, capital grants and gifts and University funds. University funds are obtained either by borrowing, thereby obligating the University to make interest and principal payments on debt or through the use of funds accumulated over a period of time, when revenues were greater than expenses. In my previous report, I demonstrated that of the total amount spent on capital projects from 2004-2009, 5 % came from the state, 7 % came from capital gifts and grants and the remaining 88 % came from the University. Adding the additional years 2010 and 2011 shows that capital financing from the state has declined accounting for only 4% of capital spending and the share financed by the University has increased to 89%. These changes are reflected in Figure 7.

Table 5 Capital Assets For the year ending June 30 Thousands of \$						
	2006	2007	2008	2009	2010	2011
Land and improvements	\$40,616	\$46,566	\$45,590	\$52,102	\$79,440	\$99,860
Buildings	\$866,100	\$973,207	\$1,014,107	\$1,122,491	\$1,141,013	\$1,162,413
Equipment and furnishings	\$294,383	\$317,294	\$341,488	\$360,767	\$380,750	\$404,136
Collections and works of art	\$7,215	\$8,763	\$8,762	\$8,853	\$8,673	\$8,872
Capital leasehold	\$14,460	\$14,715	\$14,719	\$14,715	\$14,841	\$15,003
Construction in progress	\$103,973	\$45,678	\$94,799	\$16,250	\$23,546	\$107,297
Total property, plant, and equipment	\$1,326,747	\$1,406,223	\$1,519,465	\$1,575,178	\$1,648,263	\$1,797,581
Less accumulated depreciation	\$(504,817)	\$(550,603)	\$(594,107)	\$(639,790)	\$(677,289)	\$(729,723)
Total property, plant, and equipment, net	\$821,930	\$855,620	\$925,358	\$935,388	\$970,974	\$1,067,858



One of the issues of concern associated with large amounts of capital spending is the potential increase in operations and maintenance cost. This can be a further drain on current funds. In particular, new construction, which does not have the potential to

increase enrollment or revenues from sponsored research, can be a drain on university resources.

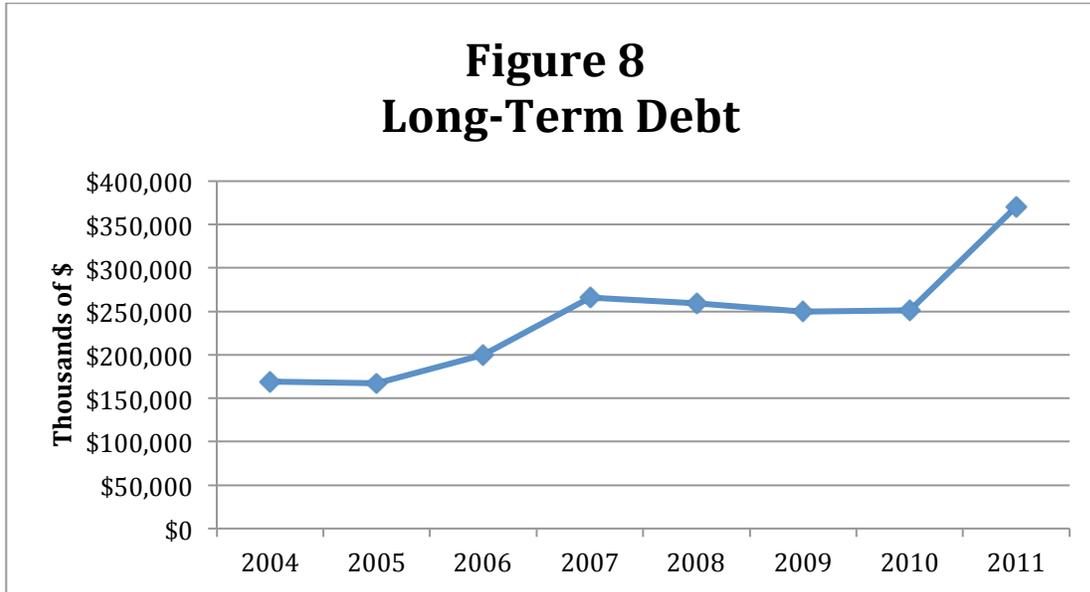
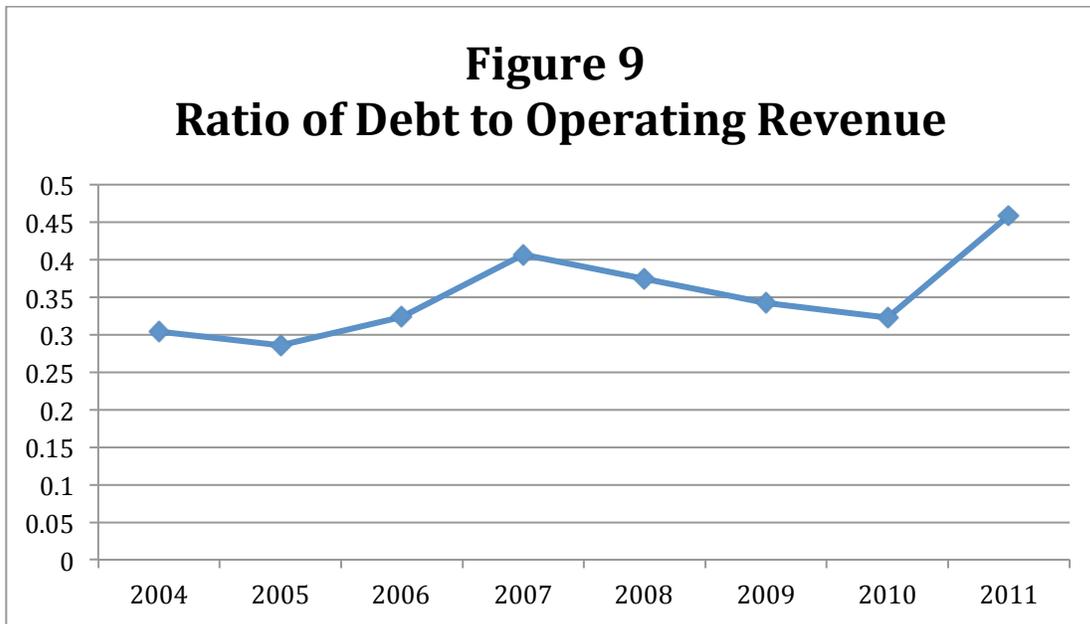


Figure 8 shows the long-term debt of the University. The University increased its debt substantially in 2006 and 2007. In 2008 and 2009 the level of debt issued by the University declined slightly. The debt load of the University was essentially unchanged in 2010 and then jumped dramatically in 2011.

One measure of the ability of an institution to meet its debt payments is the ratio of debt to operating revenue. Figure 9 shows that the ratio of debt to operating revenue for the University from 2004 to 2011. The ratio of debt to operating revenue increased in 2006 and 2007, which is not surprising given the increases in debt. However, even with the increases the ratio of debt to revenue is was still fairly modest. In 2008, 2009 and 2010 the ratio of debt to operating revenue decreased and was just slightly above the ratio for 2004. However, in 2011 the large increase in debt caused the ratio of debt to operating income to increase substantially.



Total Net Assets

In for-profit businesses the difference between assets and liabilities is referred to as owner's equity. In theory, if a business were to sell off all of its assets and pay off all claims against the business the amount remaining would be the owner's claims on the business's resources. In a non-profit organization, the difference between assets and liabilities is referred to as net assets.

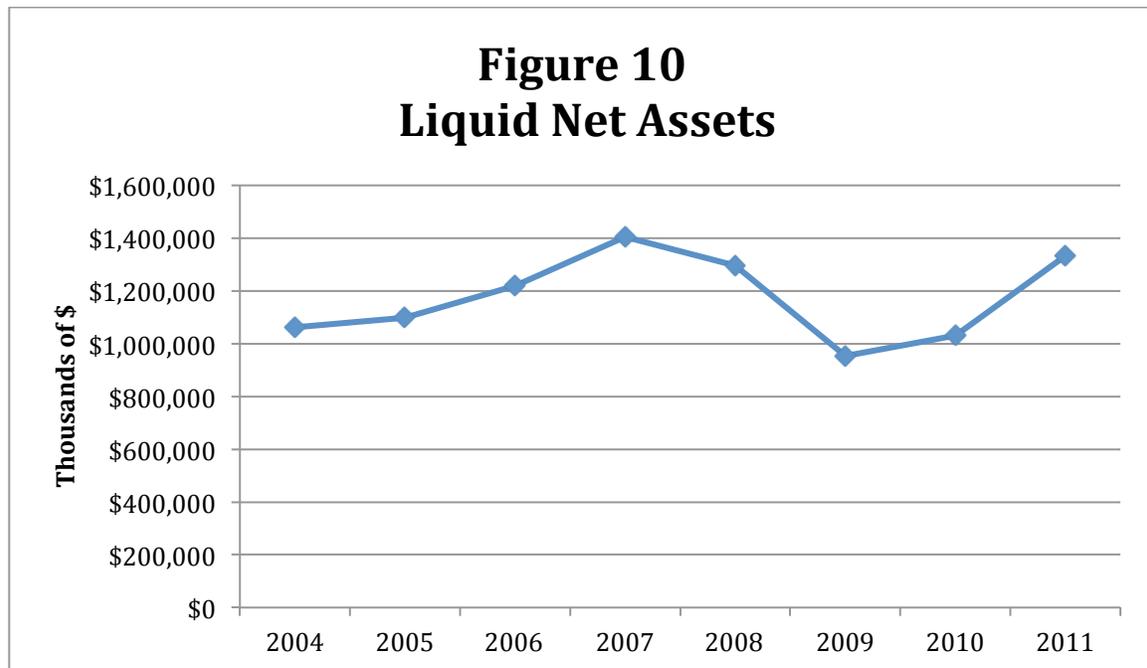
Net assets represent the accumulation of a university's assets over a period of time. A large portion of these net assets consists of the value of land, buildings, books and journals and equipment owned by the university. The values of the University's net assets are shown in Table 6.

In addition, to these real assets, universities also own financial assets such as stocks and bonds, CDs and mutual funds. Finally, universities also generally hold small amounts of cash and money in checking and savings accounts. Figure 3 showed the total net assets for the University of Delaware. Once a university invests money in its physical plant it is unusual for it to sell that asset. Thus, if a university changes its priorities and accordingly wishes to change its asset allocation it would most likely reallocate its non-plant assets. For that reason Figure 10 shows the liquid net assets of the University. Liquid net assets are total net assets minus the value of property, plant and equipment net of accumulated depreciation and net of the debt owed on these assets.

Between 2004 and 2008 the University experienced an increase in liquid net assets. In 2009 liquid net assets were estimated because the University did not report its investment in property plant and equipment. In previous years, the University had always

broken down its unrestricted net assets into net assets designated for operations, net assets designated for plant and equipment, and net assets in its endowment. For some reason starting in 2009, management decided not to report the value of property plant and equipment. So that we could obtain a consistent measure of unrestricted liquid net assets over time I subtracted the amount invested in property plant and equipment and the debt associated with that property plant and equipment from unrestricted net assets, which provides an estimate of liquid unrestricted net assets. This procedure was somewhat different than the procedure I used in the initial report because; in the initial report I only had to estimate the value of property plant and equipment for one year. Using this estimate, we calculated liquid unrestricted net assets, which was then combined with temporarily restricted net assets and permanently restricted net assets to get an estimate of total liquid net assets.

Liquid net assets increased from \$1.1 billion in 2004 to \$1.4 billion in 2007. In 2008 and 2009 liquid net assets declined. The declines in 2008 and 2009 are largely due to declines in the value of the University's investments resulting from the collapse of financial markets in 2008 and 2009. By the end of fiscal 2009 the University had \$957 million in liquid net assets. In 2010 and 2011 there were substantial increases in liquid net assets with liquid net assets reaching \$1.3 billion in 2011.



Restricted and Unrestricted Funds

Net assets at most public universities are divided into restricted and unrestricted net assets. Restricted net assets are net assets whose use is subject to restrictions imposed by external entities e.g., government or donors.

Restricted net assets that are non-expendable are subject to external stipulations and the corpus must be maintained. Examples of non-expendable restricted net assets are the University's endowment.

Restricted net assets that are expendable are subject to restrictions that will expire or subject to restrictions that determine how certain net assets must be spent. An example would be, when the University receives a capital appropriation from the state and deposits those funds in an account until they are spent for construction.

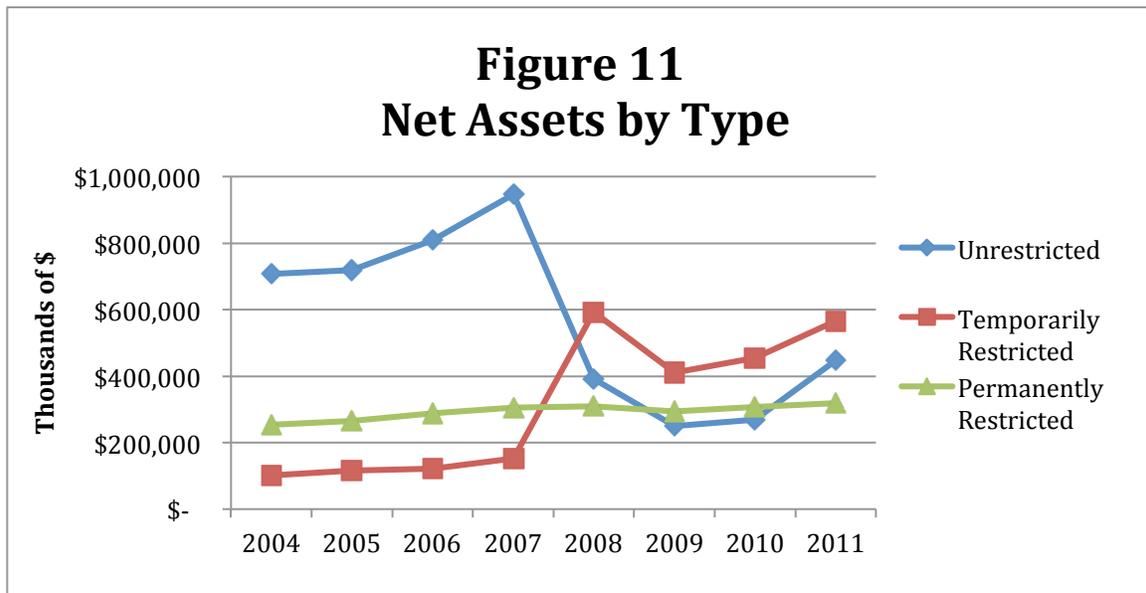
Finally, there is a category of unrestricted net assets, which are net assets that the University can use for any lawful purpose.

Since the University of Delaware chooses to follow FASB standards for reporting rather than GASB, net assets are classified as unrestricted, (defined above), temporarily restricted, or permanently restricted. Temporarily restricted net assets mean that donor stipulations must be met and meeting those stipulations might involve actions taken by the University or the passage of time. Permanently restricted net assets are subject to donor stipulations permanently. Generally, the corpus of these permanently restricted assets must be maintained but the investment earnings can be spent in accordance with donor stipulations.

Table 6 Net Assets For the year ending June 30 Thousands of \$						
	2006	2007	2008	2009	2010	2011
Unrestricted	\$809,551	\$967,078	\$392,093	\$252,932	\$269,244	\$447,003
Temporarily Restricted	\$122,034	\$152,997	\$593,322	\$410,205	\$454,692	\$566,294
Permanently Restricted	\$287,634	\$305,738	\$309,586	\$293,856	\$306,923	\$319,595
Liquid Assets	\$1,219,219	\$1,425,813	\$1,295,001	\$956,993	\$1,030,859	\$1,332,892
Investment in Property, Plant & Equipment	\$610,960	\$594,396	\$639,073	\$657,744	\$688,782	\$670,090
Total Net Assets	\$1,830,179	\$2,020,209	\$1,934,074	\$1,614,737	\$1,719,640	\$2,002,982
Total Debt	\$199,787	\$266,115	\$259,096	\$249,518	\$251,366	\$371,047
Operating Expenses	\$540,047	\$540,047	\$540,047	\$540,047	\$737,466	\$776,076
Ratios:						
Viability Ratio	4.05	3.63	3.28	2.14	2.34	2.35
Primary Reserve Ratio	1.50	1.79	1.57	0.99	0.80	1.12

Table 6 and Figure 11 show the net assets divided into unrestricted, temporarily restricted and permanently restricted net assets. Between 2004 and 2007 there was a substantial increase in unrestricted net assets. In 2004 unrestricted net assets were \$707.1 million and by 2007 they had risen 36.7 % reaching \$967.1 million. Then in 2008 there was a dramatic reduction in unrestricted net assets with unrestricted net assets falling to \$392.1 million. Then in 2009 there was a further decline in unrestricted net assets with unrestricted net assets falling to \$252.9 million. In 2010 unrestricted net assets rose to \$269.2 million and then in 2011 jumped to \$447 million.

At first glance it would appear that the University had suffered a substantial loss in the value of its unrestricted net assets. However, it is important to note that in 2008 when unrestricted net assets declined from \$967.1 million to \$392.1 million, there was also a sharp increase in temporarily unrestricted net assets, which rose from \$153 million to \$593.3 million. A large portion of these changes can be explained by the fact that the University reclassified donor-related endowment not classified as permanently restricted, from unrestricted to temporarily restricted in following FASB Staff Position No. 117-1. Reclassification does not necessarily imply any change as to how these reclassified net assets can be used. To get a more complete picture of what happened to the value of the University's net assets it would be reasonable to combine the unrestricted and temporarily restricted net assets. Combined unrestricted and temporarily restricted net assets rose from \$808.5 million to \$1.2 billion in 2007. The combined total then declined to \$985.4 million in 2008 and then to \$663.1 million in 2009. So while at first it appeared as if there was a 73% decline in unrestricted net assets between 2007 and 2009 in reality the decline resulting from the crisis in financial markets was probably closer to 41%.



At most public universities who use GASB reporting standards, a key variable in assessing the overall financial health of an institution is known as expendable net assets. Expendable net assets are used by bond rating agencies as well as by governmental entities as a prime indicator of solvency. Expendable net assets consist of unrestricted net assets (under GASB unrestricted net assets do not include investment in plant and equipment) and expendable restricted net assets. Expendable net assets consist of assets that can legally be used for operations or for plant expenditures. In other words, expendable net assets are indicators of liquidity that provides flexibility to handle unexpected changes in revenues or expenses.

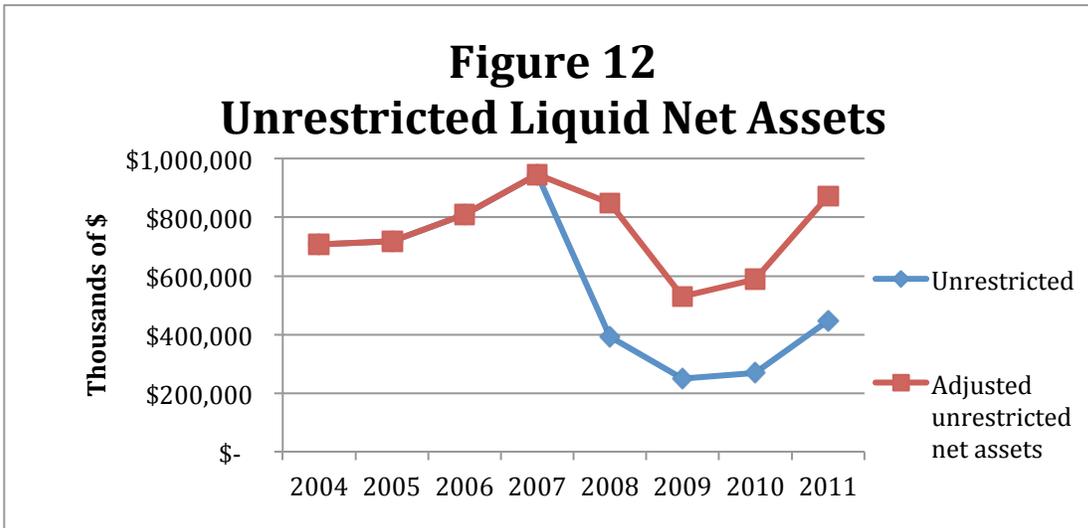
At private non-profit universities, which all follow FASB standards it is customary to report on cash and investments in the form of unrestricted net assets and temporarily restricted net assets as “available funds” which are equivalent to expendable funds i.e., they provide liquidity to deal with unexpected changes in revenues or expenses. In evaluating the liquidity of an institution it is customary to look at a couple of key ratios. First is the viability ratio, which is the ratio of expendable or available net assets to debt. The second is the primary reserve ratio that looks at the ratio of expendable or available net assets to operating expenses.

The University of Delaware seems to mix both approaches in evaluating its liquidity. There is a document on the webpage of the Office of the VP for Finance with a graph showing the primary reserve ratios for the University from 2004-2008. The University says that it calculates this ratio as expendable unrestricted net assets to operating expenses. For 2004 the ratio is just over 1.2. The only way to get a number that is approximately 1.2 is to take unrestricted endowment funds plus unrestricted funds designated for plant and divide by operating expenses, which equals 1.22. However, this leaves out unrestricted net assets set aside for operations. Clearly funds, which are set aside for operations, should be included as expendable unrestricted funds and therefore the University appears to have understated the primary reserve ratio. If one includes all unrestricted expendable net assets then the primary reserve ratio would be approximately 1.31

The problem with calculating any ratio which uses expendable unrestricted net assets in its numerator is that when net assets are reclassified as being temporarily restricted it makes it appear as if the University has suffered a significant decline in liquidity. This is why it is customary to use both unrestricted and temporarily restricted net assets when calculating liquidity ratios. A middle ground would be to try and calculate what the liquidity ratios would have been for the University in the absence of the reclassification of net asset that occurred in 2008. To make this calculation we looked at the ratio of temporarily restricted assets to permanently restricted net assets from 2004 through 2007. The ratio varied between .4 and .5 with the average being .44. Using this average we estimated what temporarily restricted net assets would have been in the absence of the reporting change. Then we subtracted the reported temporarily restricted net assets from 2008 through 2011, from the estimated temporarily restricted net assets and added this difference to the unrestricted net assets. We refer to this as adjusted

unrestricted net assets. Figure 12 shows the difference between the reported unrestricted liquid net assets and the adjusted unrestricted net assets.

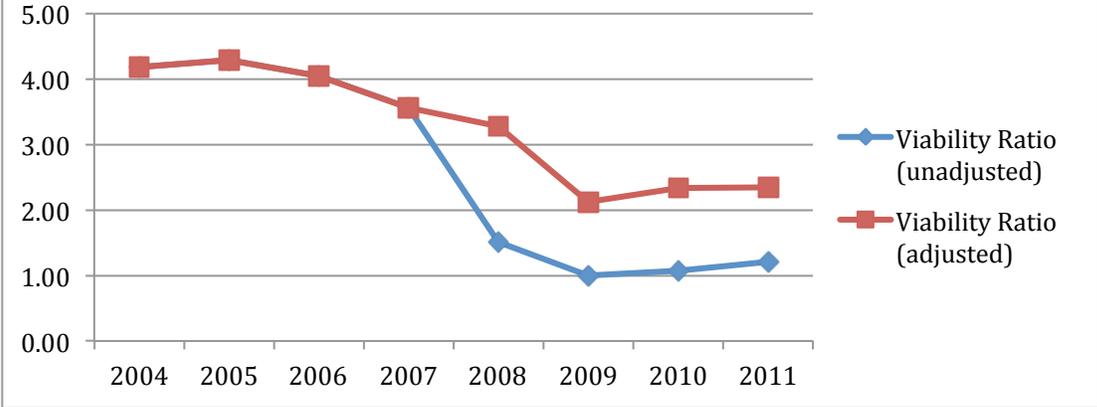
In either case, one can see the same trends, which were declines in unrestricted net assets in 2008 and 2009 and then increases in unrestricted net assets in 2010 and 2011. These increases show that the University recovered nearly all of the losses in unrestricted net assets due to the financial collapse associated with the Great Recession.



We then calculated both liquidity ratios (the viability ratio and the primary reserve ratio) using this adjusted unrestricted net assets.

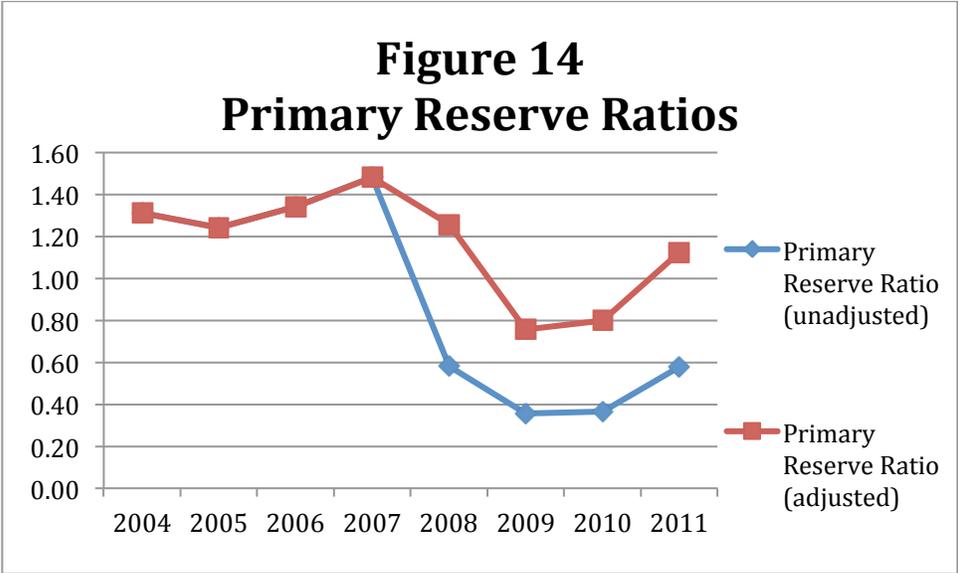
The first is the ratio is known as the viability ratio, which is the ratio of adjusted unrestricted liquid net assets to long-term debt. The declines in the viability ratio between 2005 and 2007 were due to increases in debt. Between 2004 and 2007 the University increased its debt by approximately \$100 million. The declines in 2008 and 2009 were due to declines in unrestricted net assets. Despite the declines in the University's viability ratio, it is still very high due to the relatively low level of debt held by the University. Remarkably, despite the significant increase in debt in 2011 the University's viability ratio has remained fairly stable. In 2011 the viability ratio was 2.35, which means that the University had enough reserves to pay 235 percent of its debt. Even if one were to ignore the impact of reclassifying unrestricted net assets as temporarily restricted net asset the University would have a viability ratio of 1.20 meaning that it has enough reserves to pay 120 % of its debt.

**Figure 13
Viability Ratios**



The second ratio presented in Table 6 is the primary reserve ratio, which measures the ratio of adjusted unrestricted net assets to operating expenses. This ratio increased between 2004 and 2007 and then declined in both 2008 and 2009. Again most of the decline was due to unrealized losses in investments resulting in a decline in unrestricted net assets. In 2010 and 2011 there were increases in the primary reserve ratio. In 2011 adjusted unrestricted net assets were enough to cover 112% of operating expenses or enough to cover more than 13 months of operating expenses. Using unadjusted unrestricted net asset the University could cover 58 % of its operating expenses or nearly 7 months of operating expenses. Both of these ratios are extremely high.

**Figure 14
Primary Reserve Ratios**



In summary, by 2011 the University of Delaware had total net assets of \$2 billion with \$1.3 billion in liquid assets. Adjusting for reclassification, these liquid net assets were divided between \$872 million in unrestricted net assets, \$140.9 million in temporarily restricted net assets and \$319.6 million in permanently restricted net assets. A very high proportion of the University's endowment is held outside of permanently restricted net assets which is very unusual and gives the University more financial flexibility to deal with unexpected changes in revenues and expenses. The University also has relatively little debt and its reserves, relative to operating expenses, are very high. Like most universities the University of Delaware has experienced a decline in the value of its investments between 2007 and 2009. However, almost this entire decline has been in the form of unrealized losses. Moreover, like many other universities, the University of Delaware recovered most of the losses it sustained in 2008 and 2009.

What are the income and expenses of the University?

Revenue, Expenses and Net Income

Revenues and expenses for public universities using GASB are shown in the Statement of Changes Revenue, Expenses and Changes in Net Assets. In the case of the University of Delaware since it uses FASB reporting its revenues, expenses and changes in net assets are shown in its Statement of Activities. This statement is the University's income statement or its profit and loss statement.

Revenue is the inflow of resources to a university for the services it provides. Revenues are divided into "operating revenues" and "non-operating" revenues. Operating revenues come primarily from student tuition and fees. Other sources of operating revenues are grants and contracts, sales, and auxiliaries. Sales occur when a university provides some sort of a service to the community and charges for offering that service. Auxiliaries are operations that generate revenue that are unrelated to the core mission of a university such as parking, food service or running a bookstore. Non-operating revenues include state appropriations and investment income.

Expenses, for the most part, represent an outflow of resources from a university. There are operating and non-operating expenses. Operating expenses include instructional expenses, expenses for public service, administrative services such as academic support and institutional support, plant operations and maintenance, scholarships and fellowships, expenses for auxiliary operations and depreciation. Operating expenses can be listed by functional categories such as those discussed above or they can be listed as natural categories such as wages and benefits or purchases of goods and services. Non-operating expenses consist primarily of interest paid on debt.

The difference between operating revenues and operating expenses is known as the operating gain or loss. In publicly funded or state-assisted universities using GASB accounting standards the difference between operating revenues and operating expenses will always be negative. This is because public institutions of higher education rely heavily on state appropriations, which are not counted as part of operating revenue according to GASB. This is simply an accounting quirk. If an administrator claims that a university is running an operating loss faculty members should be aware of the fact that all public institutions run operating losses and these losses in and of themselves are meaningless.

The difference between non-operating revenues and non-operating expenses is known as net non-operating revenues. The sum of operating losses and net non-operating revenues is referred to as "net income." Net income can be an important indicator of how well a university is performing financially.

However, there are two other major sources of revenue for the University. These are capital appropriations and capital grants and gifts. These sources of revenue are earmarked specifically for capital projects and as such cannot be used to support salary

and benefits directly. Nevertheless, when universities receive capital appropriations and gifts it frees up funds generated through operations, which otherwise would have to be used to support capital projects. Therefore, funding for capital projects, whether by state appropriation or by gift, is an important source of revenue. Unfortunately, capital appropriations and gifts tend to be lumpy and so it may be difficult to count on them as part of a regular revenue stream. However, most universities have a fairly good idea of a certain minimum level of capital appropriations and gifts and can factor these revenues into their spending plans.

Net income plus capital appropriations and gifts are equal to the increase or decrease in net assets. The change in net assets is in effect the bottom line for a university in a given year. If there is an increase in net assets the flow of revenue into the university has been greater than the outflow of expenses, and if there is a decrease in net assets the university has experienced a loss.

A final issue that demands our attention in trying to understand revenues and expenses is the treatment of depreciation. Historically universities did not account for depreciation of fixed assets. Therefore, at the end of a fiscal year, if revenues exceeded expenditures universities experienced an increase in “fund balances.” An increase in fund balances was the equivalent to an increase in net assets except that net assets also account for depreciation.

Depreciation is an expense, but it is a non-cash expense. Depreciation is a way of allocating the cost of fixed capital over the useful life of an asset. In theory, the cost related to the use of a fixed asset in a given year depends on the wear and tear on fixed assets. It is important for any business to take into account the cost of producing a good or service so that it can charge a price for the good or service that at a minimum covers the cost of production. However, unlike other expenses, depreciation does not involve making cash payments to some entity external to a university. When a university has an expense for wages or utilities it has to write a check to cover that expense, which reduces a university’s cash holdings. When a university claims depreciation as an expense, it reduces its net income or the change in net assets on paper, but there is no actual outflow of cash.

One question that should be raised is whether depreciation in universities is a legitimate cost. Unlike private for-profit businesses, universities receive capital appropriations and gifts to fund renewal and replacement of assets. If the cost of a building is covered entirely by capital appropriations and gifts then there is no cost incurred by the university and so there is nothing to allocate. In contrast, for-profit businesses, at least in theory, are supposed to fund renewal and replacement of assets without the assistance of government or private donors. Therefore, in looking at the net income of universities, one should probably discount depreciation as an expense.

Table 7
Statement of Activities
For the year ending June 30
Thousands of \$

	2006	2007	2008	2009	2010	2011
Operating Revenue:						
Tuition and Fees	\$210,971	\$219,900	\$235,398	\$260,897	\$296,648	\$322,634
Contributions	\$18,974	\$19,766	\$20,027	\$20,857	\$19,885	\$18,816
Contracts and other exchange transactions	\$124,168	\$129,586	\$136,432	\$135,371	\$165,951	\$175,151
State operating appropriations	\$115,666	\$122,828	\$127,166	\$126,744	\$117,873	\$116,152
Endowment spending payout	\$39,898	\$45,869	\$49,489	\$54,158	\$46,239	\$43,902
Other investments payout	\$11,174	\$12,396	\$14,010	\$9,318	\$6,896	\$6,334
Activities of educational departments	\$6,405	\$7,152	\$7,557	\$9,247	\$9,725	\$10,388
Sales and services of auxiliary enterprises	\$77,568	\$81,818	\$88,072	\$92,929	\$99,519	\$101,902
Other revenue	\$12,330	\$14,736	\$14,235	\$18,960	\$15,665	\$14,808
Total Operating Revenue	\$617,154	\$654,051	\$692,386	\$728,481	\$778,401	\$810,087
Operating Expenses:						
Educational and General:						
Instruction and departmental research	\$267,336	\$279,293	\$295,173	\$307,660	\$315,998	\$341,221
Sponsored research	\$99,782	\$103,425	\$105,697	\$109,585	\$123,126	\$130,400
Extension and public service	\$36,773	\$40,492	\$44,994	\$45,092	\$43,719	\$43,312
Academic support	\$49,120	\$54,900	\$55,563	\$56,805	\$57,904	\$59,480
Student services	\$20,725	\$22,202	\$24,392	\$26,251	\$27,494	\$28,002
General institutional support	\$51,858	\$57,985	\$60,451	\$63,946	\$69,465	\$74,205
Student aid	\$4,846	\$6,144	\$5,722	\$5,827	\$4,805	\$5,475
Reclassification of funds	\$102	-\$1,013				
Independent Operations					\$556	\$1,183
Total educational and general expenses	\$530,542	\$563,428	\$591,992	\$615,166	\$642,511	\$682,095
Auxiliary enterprises	\$73,105	\$76,209	\$82,999	\$86,938	\$94,955	\$93,981
Total operating expenses	\$603,647	\$639,637	\$674,991	\$702,104	\$737,466	\$776,076
Reclassification of funds			-\$1,402	-\$1,224		
Change in net assets from operating activities	\$13,507	\$14,414	\$18,797	\$27,601	\$40,935	\$34,011

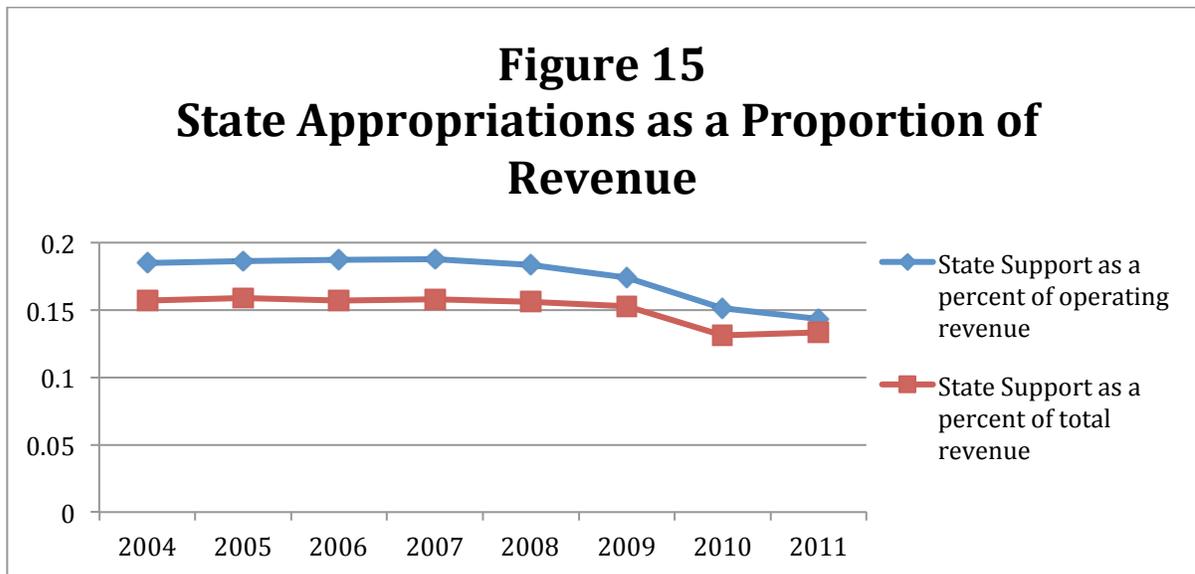
Table 7 Continued
Statement of Activities
For the year ending June 30
Thousands of \$

	2006	2007	2008	2009	2010	2011
Non-operating Activities:						
Net realized and unrealized investment gains	\$130,388	\$174,134	-\$89,844	-\$328,939	\$97,505	\$203,192
Decrease (increase) in post retirement obligations					\$(24,194)	\$31,580
Endowment income	\$28,606	\$42,032	\$46,533	\$32,661	\$19,198	\$18,979
Endowment spending payout	-\$39,898	-\$45,869	-\$49,489	-\$54,158	\$(46,239)	\$(43,902)
Contributions for endowment and life income funds	\$16,765	\$9,630	\$6,888	\$6,898	\$6,196	\$5,338
Contributions for buildings	\$11,841	\$4,804	\$2,097	\$1,410	\$15,911	\$14,082
State capital appropriations	\$7,000	\$4,600	\$3,500			
Hotel operations, net	-\$1,659	-\$17	-\$918	-\$1,567	\$(1,243)	\$(67)
Technology corporation operations, net	-\$529	-\$383				\$1,905
Net change in asset retirement obligation liability		-\$3,093	-\$2,972	-\$1,256	\$606	\$6,226
Other	\$3,080	\$1,189	-\$2,129	-\$3,211	\$(4,116)	\$12,115
Reclassification of funds	\$102	-\$1,013	\$1,402	\$1,224		
Net assets released from restrictions						
Change in Net assets	\$169,203	\$200,428	-\$66,135	-\$319,337	\$104,559	\$283,459
Effect of change in adoption of FAS 158		-\$30,398				
Cumulative effect of change in accounting principle	-\$4,440					
Net assets at beginning of year	\$1,665,416	\$1,830,179	\$2,000,209	\$1,934,074	\$1,614,737	\$1,719,640
Net assets at end of year	\$1,830,179	\$2,000,209	\$1,934,074	\$1,614,737	\$1,719,296	\$2,003,099

Table 7 shows the consolidated Statement of Activities for the University between the years 2006-2011. Between 2004 and 2009 operating revenues to the University increased from \$556.3 million to \$728.5 million, an average annual increase of 5.5 %. In

2010 increased by 6.8% and in 2011 it increased by 4.1% reaching \$810.1 million. The most important source of operating revenue is tuition and fees. The tuition and fees shown in Table 8 are net of scholarships. In 2004, tuition and fees were \$191.9 million and by 2009 they had risen to \$260.9 million, an average annual increase of 6.3 %. In 2010 tuition and fees increased 13.7% and in 2011 increased to \$322.6 million, an increase of 8.8%.

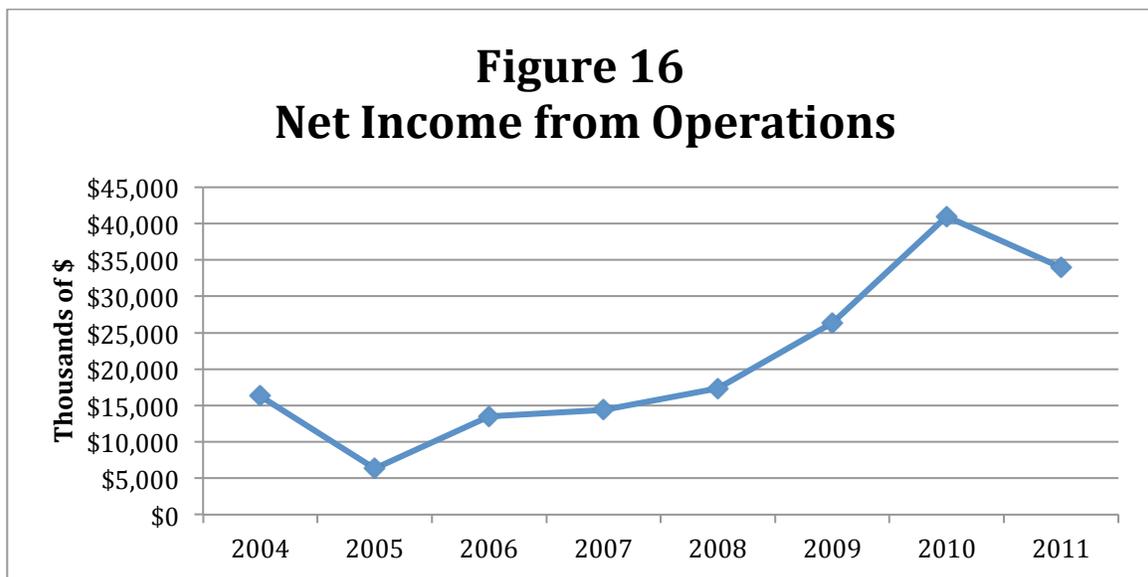
The second largest source of revenue is contracts and other exchange transactions, which should include government grants. The third largest source of operating revenue is state appropriations. State operating appropriations as a percentage of operating revenue have been fairly stable. This is very unusual because in most states state support represents a decreasing share of operating revenue. Figure 15 shows the state appropriations for operations as a proportion of operating revenue and total revenue. In 2004 state appropriations accounted for 18.5 % of operating revenues and 13.9 % of total revenues. In 2009, state-operating appropriations accounted for 17.4 % of operating revenue and 16.4 % of total revenues. State operating appropriations, as a percentage of operating revenues and total revenue, have continued its downward trend. In 2011 state support as a percent of operating revenue declined to 14.3% and state support as a percentage of total revenue declined to 12.9%.



Sales and services of auxiliary enterprises is also an important source of revenue. Sales and services of auxiliaries have grown from \$69.8 million in 2004 to \$101.9 million in 2011, an average annual increase of 5.6 %. Finally, contributions are important sources of revenue. Contributions grew from \$18.8 million to \$20.8 million from 2004 to 2009. In 2010 there was a slight increase in contributions and then in 2011 a decline in contributions. Endowment payouts are shown as a source of revenue; however, there is always an offsetting expense so the endowment payouts have no effect on the net income of the University.

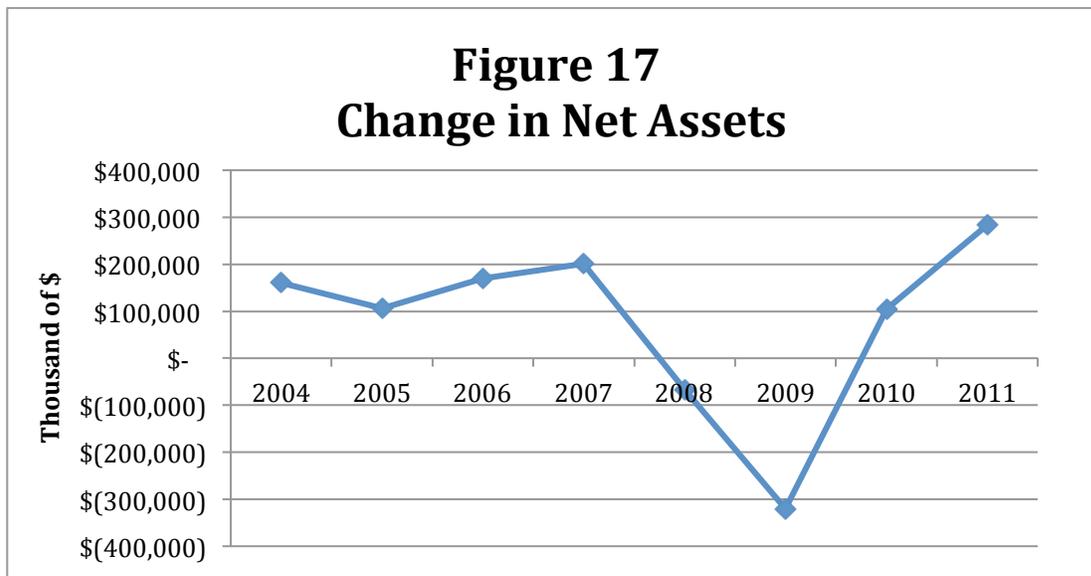
On the expense side, operating expenses increased from \$540 million in 2004 to \$702 million in 2009, an average annual increase of about 5.4 %. By 2011 operating expenses reached \$776.1 million and over the entire period from 2004 through 2011 operating expenses increased at an average annual rate of 5.3%. It is important to note that FASB reporting standards do not require that depreciation be reported as a separate expense so the expense of depreciation is included in each of the various functional categories. During the same timeframe 2004-2011: (a) instruction rose from \$244.1 million to \$341.2 million, an average annual increase of about 4.9 %; (b) sponsored research increased from \$83.8 million to \$123.1 million, an average annual increase of 6.5%; (c) spending on extension and public service increased from \$30.7 million to \$40.3 million an average annual increase of 5%; (d) spending on academic support increased from \$43.1 million to \$59.4 million, an average annual increase of 4.7 %; and (e) spending on institutional support increased from \$50.2 million to \$74.2 million, an average annual increase of 5.7 %. Finally, spending on student services increased from \$19.6 million to \$28 million, an average annual increase of 5.3%. Spending on student aid increased from \$4.8 million to \$5.8 million from 2004-2009 and then declined to \$4.8 million in 2010 and then rose to \$5.5 million in 2011 which was below the high point of \$6.1 million in 2007.

The category change in net assets from operating activities represents the University’s net income. In 2004, the University had a net income of \$16.3 million. The following year, the University experienced a decline in net income earning only \$6.3 million. In each of the successive years, the University’s net income increased, reaching \$27.6 million in 2009. In 2010 net income increased to \$41 million and then declined to \$34 million, which was still substantially higher than net income in 2009. Figure 16 shows the net income from operations for the University. It is important to remember that net income from operations includes revenue from the endowment payout but operating expenses do not include the offsetting expense.



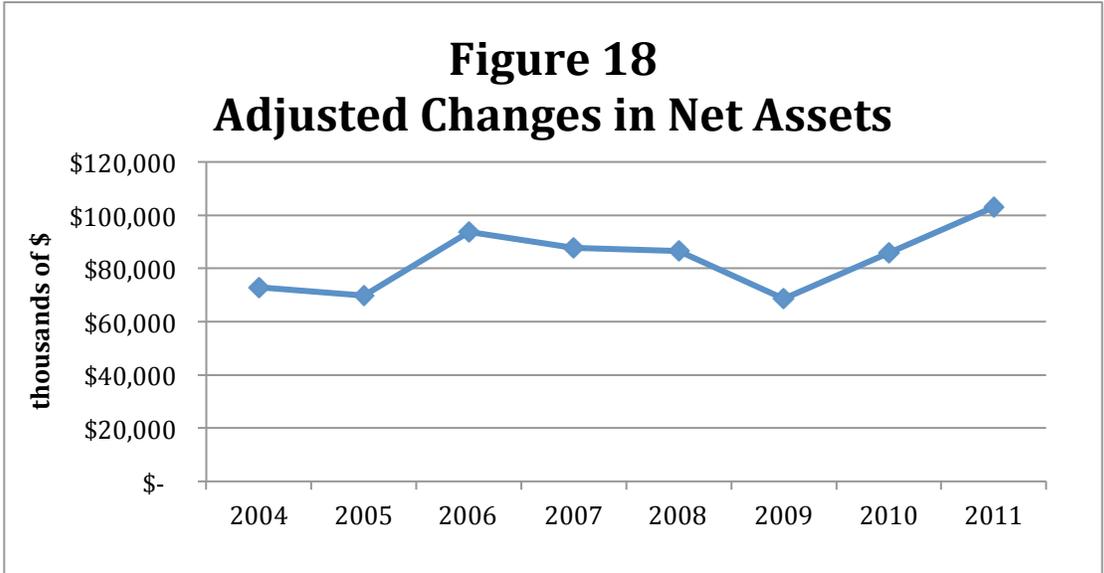
Finally, in Table 7, we see the bottom line for the University, which is the change in net assets. The change in net assets includes not only the net income of the University, but also capital appropriations, capital gifts and grants and additions to the University’s endowment. To the extent that these are regular sources of revenue they can be counted as revenue and hence will add to “net income.” However, these sources of revenue clearly cannot be used for operating purposes. Figure 17 shows the change in net assets. The change in net assets can fluctuate substantially because it includes unrealized gains and losses on investments. Realized gains or losses represent real gains and losses but unrealized gains and losses are in effect paper gains and losses.

Most of what is shown in the category realized and unrealized gains and losses represent unrealized gains and losses. Therefore, we calculate the adjusted changes in net assets to give a better picture of the bottom line of the University. The adjusted change in net assets, shown in Figure 18, starts with the change in net assets and subtracts realized and unrealized gains and losses on investments and adds .045 % of a moving average of the value of investments in the past three years. In addition, starting in 2010 the University started adding declines in post-retirement obligations and subtracting increases in post-retirement obligations from changes in net assets. Since this was not done in previous years and these changes do not represent cash changes we also adjust for this change to get a consistent series.



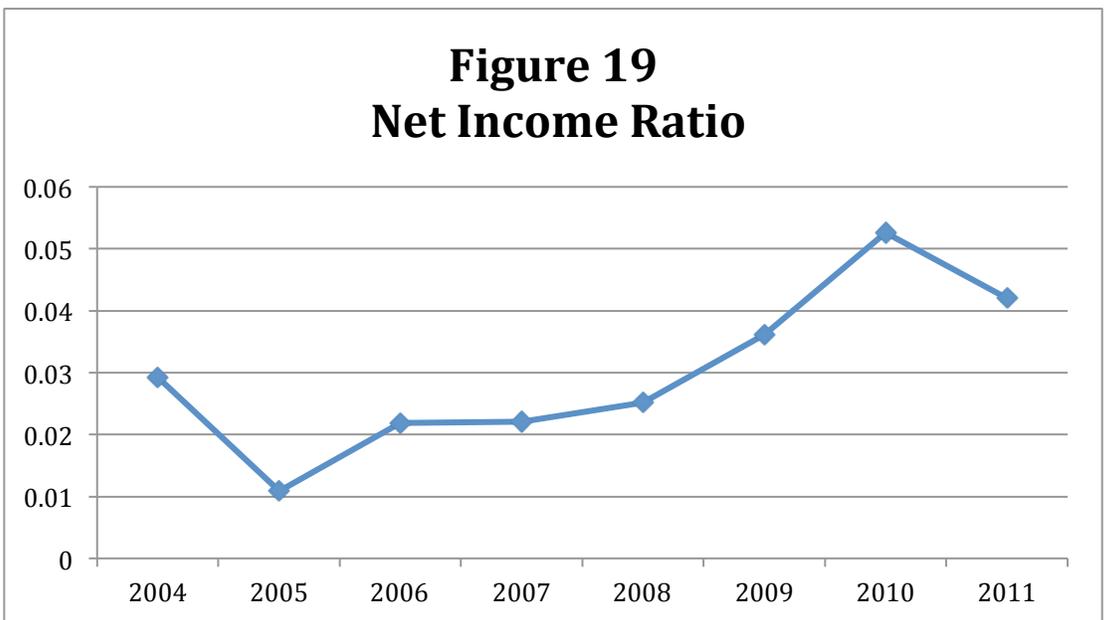
In 2004 the University had an adjusted change in net assets of \$72.9 million. In 2005 the adjusted change in net assets fell to \$69.7. In 2006 the adjusted change in net assets was \$93.7 million and then fell slightly to \$87.8 million in 2007. In 2008 the University had an adjusted change in net assets of \$86.5 million and in 2009 had an adjusted change in net assets of \$68.5 million. In 2010 adjusted net assets increased to \$85.8 million and then to \$102.9 million in 2011. Bond rating agencies, such as

Moody's and Fitch, routinely make these types of adjustments when looking at the change in net assets for universities.

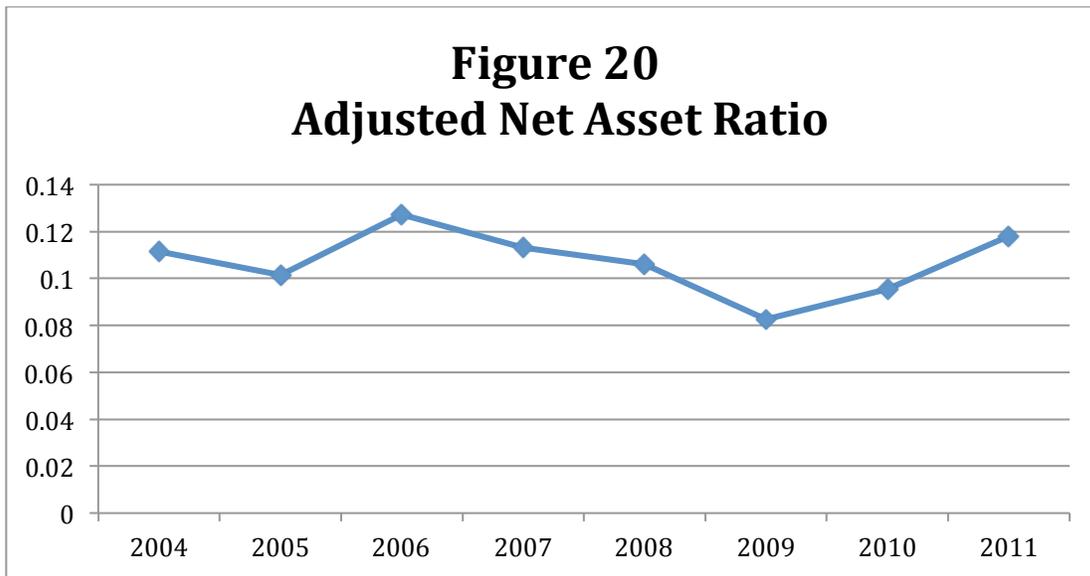


Total Operations Ratios

Figure 19 shows the net income ratio for the University from 2004-2011. The net income ratio is calculated by taking the dividing the change in net operating assets (net income) by operating revenues. This net income ratio mirrors the actual net income reported previously and shows the University with a positive rate of return in all six years.



In addition to the net income ratio presented in Figure 19, we also show the adjusted net asset ratio. This is the most comprehensive measure of the net earnings of the University. It includes not only the net income of the University, but also the state capital appropriations, capital gifts and grants and additions to the permanent endowment of the University. While these sources of revenue cannot be used for operations they are important because they contribute to the overall financial strength of the institution. It is also important because it is one of the factors that bond-rating agencies look at when assessing the financial health of the institution. The adjusted net income ratio is calculated by dividing adjusted change in net assets and by adjusted total revenue. The results are shown in Figure 20.



The adjusted net asset ratio shows that the University's return on revenue has had some minor fluctuations but has been relatively stable. This means that there has not been any fundamental change in the earnings of the University over the period from 2004-2011.

How much cash flows in and out of the University?

The Cash Flow Statement:

Universities use accrual accounting. Anytime there is a change in assets or a change in liabilities these changes are reflected a university's Financial Position (Balance Sheet) and in it's Statement of Activities (Income Statement). For example if a university increases the amount of sick leave it makes available to its employees that increases the liability for compensated absences. The increase in this liability must be also be reflected in the university's Statement of Activities because the increase in a liability, other things being equal, will reduce the value of net assets. This means that an increase in sick leave must show up as an increase in expenses on the "income statement" even though the university does not have to write a check to cover this expense. This is known as a non-cash expense.

The issue of whether or not depreciation should be counted as an expense was discussed earlier in this report. Normally, when a university has an expense, it must cover that expense by writing a check or transferring funds from its bank account to individuals or businesses. This results in an outflow of cash from the university. In the case of depreciation, no cash flows out of the university. In other words, it is an expense only on paper.

An alternative view of a university's finances can be obtained by looking at the cash that flows into the university and the cash that flows out of the university. This information is found in the Statement of Cash Flows. Table 8 shows the Statement of Cash Flows for the University from 2006-2011.

The Statement of Cash Flows has four major components at most public universities. First, cash flows from operations, which includes inflows in the form of tuition and fees, grants and contracts, sales and services and outflows in the form of payments to employees, suppliers and students. The second component consists of cash flows from non-capital financing activities. The largest cash flow in this component is state appropriations. Third are cash flows from capital and related financing activities, which include inflows in the form of capital appropriations and capital grants and outflows in the form of purchases of capital assets as well as outflows for principal and interest payments. Finally there are cash flows from investing activities such as the purchase and sale of investments and interest received on investments.

Following the FASB format the University of Delaware has its cash flow in three sections; cash flows from operating activities which combines cash flows from operations with cash flows from non-capital financing activities. The next section shows cash flows from investing activities and the third item is cash flows form investments.

Table 8
Cash Flows
For the year ending June 30
Thousands of \$

	2006	2007	2008	2009	2010	2011
Cash Flows from Operating activities:						
Change in net assets	\$169,203	\$200,428	-\$66,135	-\$319,337	104,903	283,342
Depreciation	\$38,201	\$48,161	\$45,742	\$49,158	50,759	52,029
Loss on disposals	\$2,988	\$1,277	\$1,340	\$1,369	4,377	1,184
Amortization of discounts and premiums on notes and bonds payable and capital lease obligations	\$51	\$40	\$41	-\$38	-23	-70
Net realized and unrealized investment (gains) losses	-\$131,795	-\$174,645	\$89,509	\$326,215	-76,989	-206,304
Gifts of land, building and equip.	-\$417	-\$847	-\$252	-\$430	-429	-745
State capital appropriations	-\$7,000	-\$4,600	-\$3,500		-900	-1,066
Contributions for endowment	-\$16,765	-\$9,630	-\$6,888	-\$6,898	-5,771	-5,338
Contributions for buildings, gross	-\$11,841	-\$4,804	-\$2,097	-\$670	-5,655	-7,386
Contributions receivable	\$172	\$2,142	\$1,755	-\$740	-10,255	-6,696
Endowment income restricted for reinvestment	-\$964	-\$1,011	-\$870	-\$1,929	-1,582	-1,086
Changes in assets and liabilities:						
Accounts and notes receivable	\$4,406	\$2,740	-\$44	\$2,427	-10,976	-7,949
Prepaid expenses and inventories	\$688	-\$433	-\$333	-\$139	-1,693	-1,382
Interest rate swap asset		-\$1,078	\$1,078		-20	-4,684
Accounts payable, accrued liabilities and annuity and life income funds payable	-\$3,295	\$31	\$6,141	-\$15,273	8,911	17,884
Deferred revenues and students deposits	-\$118	\$457	\$223	\$650	-351	959
Interest rate swap liability	-\$13,719	-\$75	\$12,758	\$13,380		
Asset retirement obligation		\$3,093	\$2,972	\$1,256	6,375	-5,728
Compensated absences payable and postretirement benefit obligation	\$15,685	\$44,256	\$13,275	\$5,665	38,871	-17,571
Effect of change in adoption of FAS 158		-\$30,398				
Net cash provided by program activities	\$45,480	\$75,104	\$94,715	\$54,666	\$99,552	\$89,393

Table 8 Continued
Cash Flows Continued
For the year ending June 30
Thousands of \$

	2006	2007	2008	2009	2010	2011
Cash flows from investing activities:						
Proceeds from sales and maturities of investments	\$2,286,042	\$2,020,841	\$2,663,140	\$2,985,944	2,779,592	3,463,000
Purchases of investments	-\$2,275,743	-\$2,074,588	-\$2,654,002	-\$2,964,605	-2,827,804	-3,445,824
Acquisitions of property plant and equip.	-\$120,062	-\$82,281	-\$116,568	-\$60,126	-90,293	-141,575
Disbursements of loans to students	-\$3,367	-\$2,751	-\$3,085	-\$1,171	-2,277	-1,507
Repayments of loans	\$4,102	\$2,920	\$1,820	\$1,517	1,877	2,165
Net cash used for investing activities	-\$109,028	-\$135,859	-\$108,695	-\$38,441	-\$138,905	-\$123,741
Cash flows from financing activities:						
Repayments of principal of notes and bonds payable	-\$16,839	-\$6,280	-\$6,600	-\$79,931	-6,895	-123,922
Net proceeds from issuance of notes and bonds payable	\$49,729	\$73,009		\$70,875	9,276	244,213
Reduction in principal of capital leases	-\$422	-\$440	-\$460	-\$485	-510	-540
State capital appropriations	\$7,000	\$4,600	\$3,500		900	1,066
Endowment income restricted for reinvestment	\$964	\$1,011	\$870	\$1,929	1,582	1,086
Contributions for endowment	\$16,765	\$9,630	\$6,888	\$6,898	5,771	5,338
Contributions for buildings, gross	\$11,841	\$4,804	\$2,097	\$670	5,655	7,386
Advances from federal government for student loans	\$84	\$166	\$222	\$260	82	96
(Increase) decrease in restricted cash and cash equiv.	-\$9,177	-\$2,553	\$699	-\$476	2,271	-93,792
Net cash (used for) provided for financing activities	\$59,945	\$83,947	\$7,216	-\$260	\$18,132	\$40,931
Net increase (decrease) in cash and cash equiv.	-\$3,603	\$23,192	-\$6,764	\$15,965	-\$21,221	\$6,583

In our analysis we will concentrate on the first component of the cash flow statement, cash flows from operations. Cash flows from operations show the cash coming into the institution and the cash going out, thereby excluding non-cash expenses such as depreciation or the cost of disposal of assets.

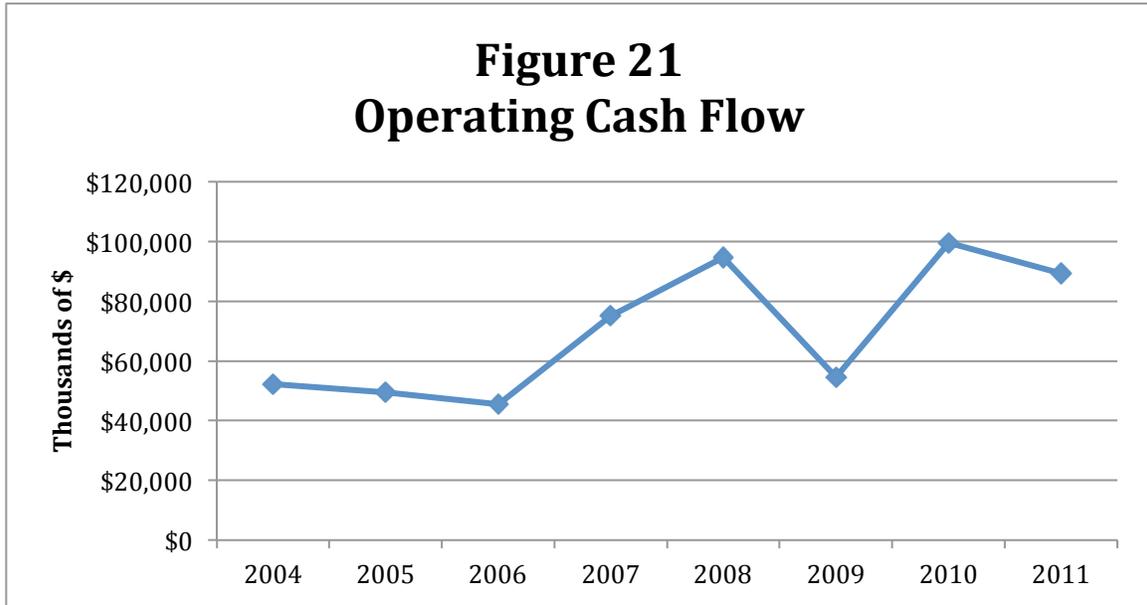


Table 8 shows the operating cash flows from 2006-2011 and Figure 21 shows the operating cash flows for the University from 2004 to 2011. Cash flows declined slightly from \$52.3 million in 2004 to \$45.5 million in 2006. In 2007 and 2008 there were sharp increases in cash flows and in 2009 cash flows declined to \$54.6 million. In 2010 cash flows from operations increased to \$99.5 million and then declined slightly to \$89.4 million. This shows that when all is said and done, the University is running a substantial cash surplus every year.

What are the University's sources of revenue and how does it allocate its expenses?

Sources of Revenue

Figures 22 and 23 show the percentage of operating revenue from various sources for the years 2004 and 2011. (We have excluded endowment-spending payout since it has an offsetting expense). The University has diversified sources of revenue. In 2004 the three largest sources of revenue for the University were tuition, contracts and other exchange transactions and state appropriations all of which accounted for about 78 percent of revenues in 2004.

Between 2004 and 2011 tuition and fees increased in importance as a source of revenue increasing from 37 % to 42 % of revenues. State appropriations declined from 20% to 15% of revenue. Although the University has become more dependent on tuition it still has a diversified revenue base. Apart from tuition and fees and state appropriations the university gets a substantial portion of its revenue from contracts and other exchange operations and sales and services of auxiliary operations.

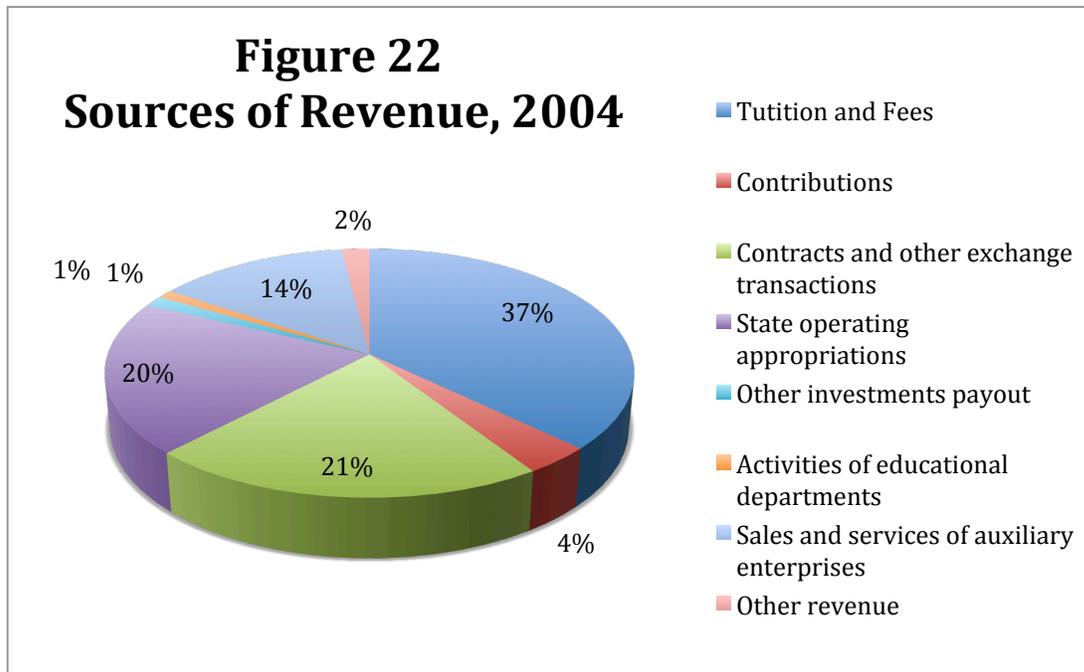
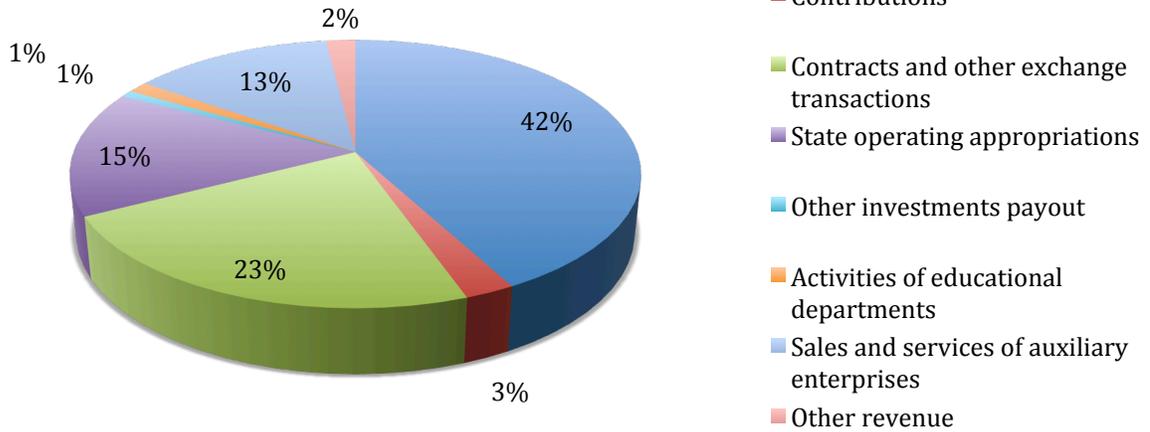


Figure 23
Sources of Revenue, 2011



Allocation of Expenses

When most faculty members want to understand spending priorities they look at annual budgets. Again, budgets are simply planning documents. The actual spending priorities of the University are clearly reflected in their actual expenditures. Figures 24 and 25 show the allocation of expenses after subtracting depreciation in 2004 and 2011 respectively.

Figure 24
Allocation of Resources, 2004

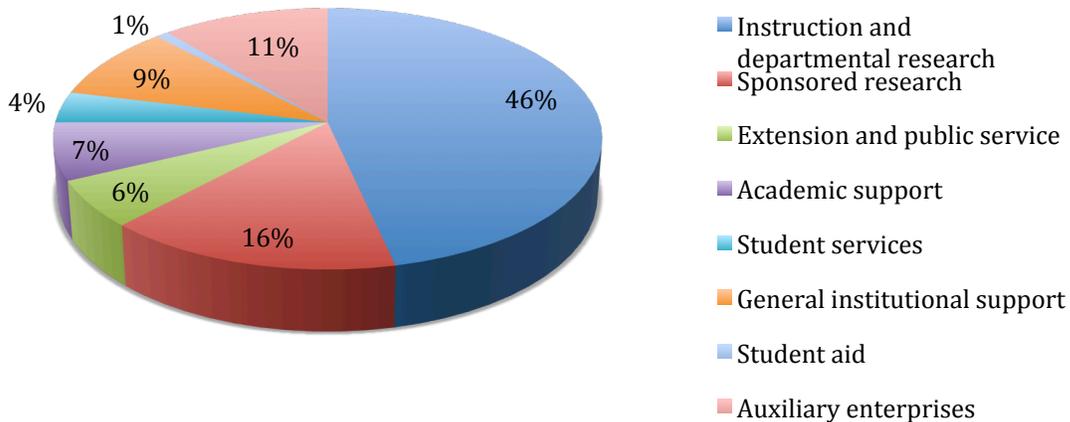
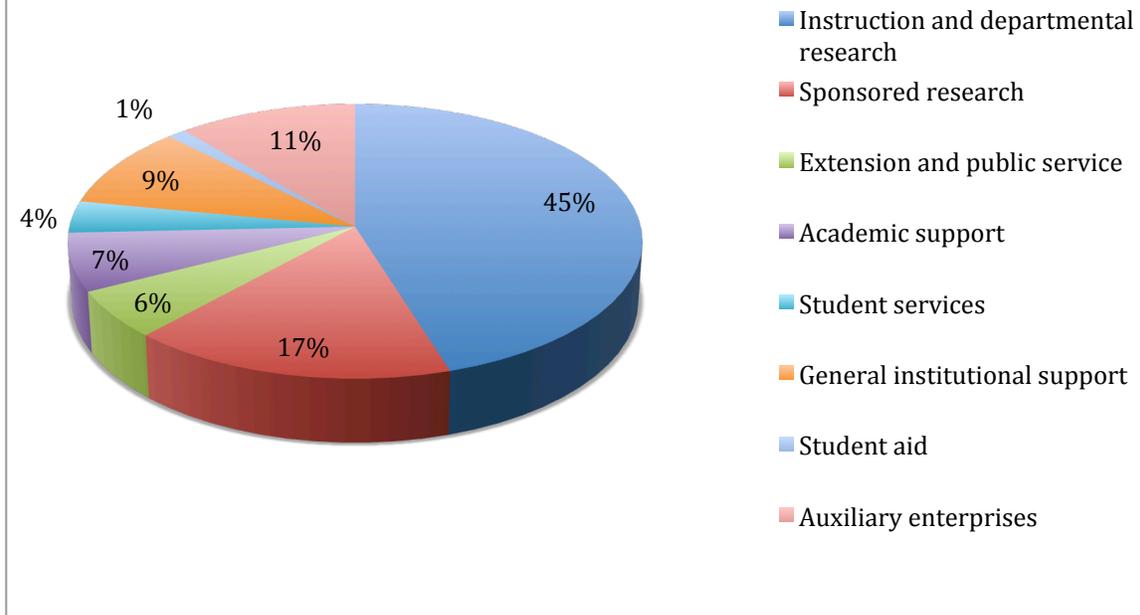


Figure 25
Allocation of Resources, 2011



Instruction is the largest single expense followed by spending on research. Between 2004 and 2009 spending on instruction declined from 46 % to 45 % and sponsored research declined from 16% to 15%. In contrast spending on extension and public service increased from 6% to 7% and spending on auxiliary enterprises increased from 11% to 12%. In 2011 the main change in the allocation of resources was an increase in the proportion of expenses spent on sponsored research, which increased from 15% to 17%, a decrease in the proportion of spending on auxiliary enterprises from 12% to 11% and a decrease in the percentage of resources spent on extension and public service from 7% to 6%.

Finally, wages, benefits and post retirement benefits for instruction and department research accounted for 33.6% of operating expenses in 2004 and 32.3% of operating expense in 2011. Most of this represents compensation for faculty. If the percentage of operating expenses spent on wages, benefits and post retirement benefits in instruction and departmental research had remained constant the University would have spent an additional \$10 million dollars on compensation in the category of instructional and departmental research.

Conclusion

This update shows that the University of Delaware remains in excellent financial condition. The University has diversified sources of revenue, has had a positive operating cash flow for the last 8 years, has relatively little debt, and has stable enrollment.

Enrollment at the University has grown at an average annual rate of 0.6% between 2004 and 2011 and over the last 4 years it has grown at an average annual rate of 1.4%.

The University has assets of \$2.7 billion and liabilities of \$736.1 million, leaving net assets of \$2 billion. These net assets are the equivalent of “net worth” in the for-profit sector. The University has \$1.3 billion in liquid assets and of those liquid assets it has \$1 billion are held as unrestricted or temporarily restricted net assets. Using adjusted unrestricted net assets as a measure of reserves the University has sufficient reserves to cover 235% of long-term debt and can cover operating expenses for a period of nearly 13 months.

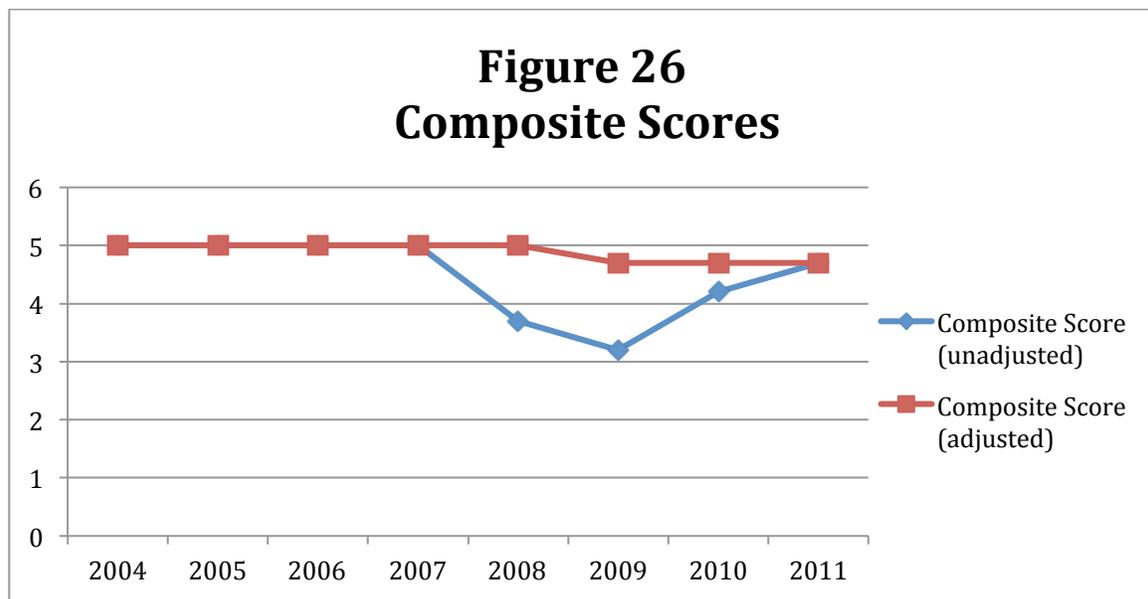
The University of Delaware’s financial condition can be summarized by looking at three key indicators that the Ohio Board of Regents uses to assess the financial health of universities in Ohio in accordance with Senate Bill 6. These ratios are similar to those used by major bond rating agencies. The first is the ratio is known as the viability ratio, which is the ratio of expendable net assets to long-term plant debt. The second ratio is the primary reserve ratio, which measures the ratio of expendable net assets to operating expenses. The final indicator is the net asset ratio, which is the change in net assets divided by operating and non-operating revenues (total revenue). The Ohio Board of Regents has developed a methodology to categorize all three ratios using a scale of whole numbers from 0 to 5, with 5 being the highest score. These scores are then used to calculate a composite index that reflects the bond rating that would be given to an institution. These bond ratings reflect the overall financial health of the institution.

Table 9a Composite Scores For the year ending June 30								
	2004	2005	2006	2007	2008	2009	2010	2011
Viability Score	5	5	5	5	4	4	4	4
Primary Reserve Score	5	5	5	5	5	4	4	5
Net Asset Score	5	5	5	5	0	0	5	5
Composite Score	5	5	5	5	3.7	3.2	4.2	4.7

Table 9b Composite Scores For the year ending June 30								
	2004	2005	2006	2007	2008	2009	2010	2011
Viability Score	5	5	5	5	5	4	4	4
Primary Reserve Score	5	5	5	5	5	5	5	5
Net Asset Score	5	5	5	5	5	5	5	5
Composite Score	5	5	5	5	5	4.7	4.7	4.7

Using unadjusted and adjusted scores respectively, Table 9a and Table 9b show the individual scores and composite scores for the University of Delaware from 2004 through 2011. Figure 26 provides a graphical view of the composite scores for the period 2004 through 2011. The University had a composite score of 5 using both unadjusted and adjusted scores from 2004 through 2007. In 2008 using unadjusted data the composite score declined to 3.7 because of declines in the viability score and the net assets score. The changes in both of these scores were due almost entirely to the decline in unrestricted net assets due to the reclassification of net assets from unrestricted to temporarily restricted. In 2009 the decline in the primary reserve score contributed to a further decline in the composite score, which reached 3.2. This decline was largely driven by a decline in unrestricted net assets due to unrealized losses in investments. In 2010 the composite score increased to 4.2 and then in 2011 it reached 4.7.

The numbers in Table 9a exaggerate the deterioration in financial condition because of the reclassification of unrestricted net assets and the decline in both restricted and temporarily restricted net assets due to unrealized losses in investments. Adjusting for these two problems gives a better picture of the University's overall financial condition.



Using adjusted scores; the University had a composite score of 5 from 2004-2008. In 2009 there was a decline in the composite score to 4.7, which is still extremely high. Interestingly, adjusted score remained at 4.7 in both 2010 and 2011. The major factor behind the deterioration in 2009 was the decline in the viability score, which was primarily the result of the collapse in financial markets. The University of Delaware, unlike many universities seems to have been largely unaffected by the financial crisis and the Great Recession.

Although there is a great deal of uncertainty surrounding the state budgets and the economy in general, the University of Delaware remains in excellent financial condition and is certainly in a position to offer competitive salaries and benefits to its faculty.