

**An Analysis of the Financial Statements
of
Rutgers University
Fiscal Years 1998-2002**

Prepared for AAUP

By

**Rudy Fichtenbaum
Professor of Economics
Department of Economics
Wright State University
Dayton, OH 45435**

(937) 775-3085

rfichtenbaum@sbcglobal.net

Introduction

This report provides an analysis of the financial status of Rutgers University for the fiscal years 1998 through 2002. The analysis contained in this report is based on information contained in the audited financial statements and other information that appears in the Annual Financial Reports of the University for the aforementioned years.

Universities, like other non-profit organizations use a system of accounting known as “fund accounting.” The reason why universities use this system of accounting has to do with their purpose as an institution of higher learning. The goal of for-profit businesses is to earn a profit. Thus, their financial statements are designed to allow stockholders and others concerned with profitability a means to monitor performance.

Universities and other non-profit organizations have an entirely different purpose. Universities are established as institutions of higher learning 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. 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 make sure that they are expended for their intended purpose.

Since the primary purpose of fund accounting systems is to ensure that funds are expended in the manner they were intended by donors or government entities it is difficult for faculty to look at a university’s financial statements and get a true picture of the university’s financial health. Most often, faculty are misled by looking only at a university’s budget. 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, administrations routinely leave faculty positions vacant and are thus able to spend the money that has been budgeted for faculty positions for other purposes. To get a true picture of a university’s finances one must look at the actual financial statements, which represent the actual revenues and expenditures 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 in a for-profit business, revenues come into the business through the sale of goods and 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 the institution they incur expenses. The difference between the revenues that come into a university and its expenses is known as a change in fund balance. If a university takes in more revenue than it expends there is a positive increase in fund balances. Conversely, if the expenses

exceed the revenues there is a decrease in fund balances. Increase or decreases in fund balances are one of the prime indicators of how a university is performing financially.

Beginning in 2002 there were some important changes in the way universities report on their financial status due to the implementation of GASB 35. Due to the changes in financial reporting what had been referred to as a change in fund balances is now referred to as a change in net assets. This change in net assets (formerly the change in fund balances) is one of the prime indicators of how a university is performing financially.

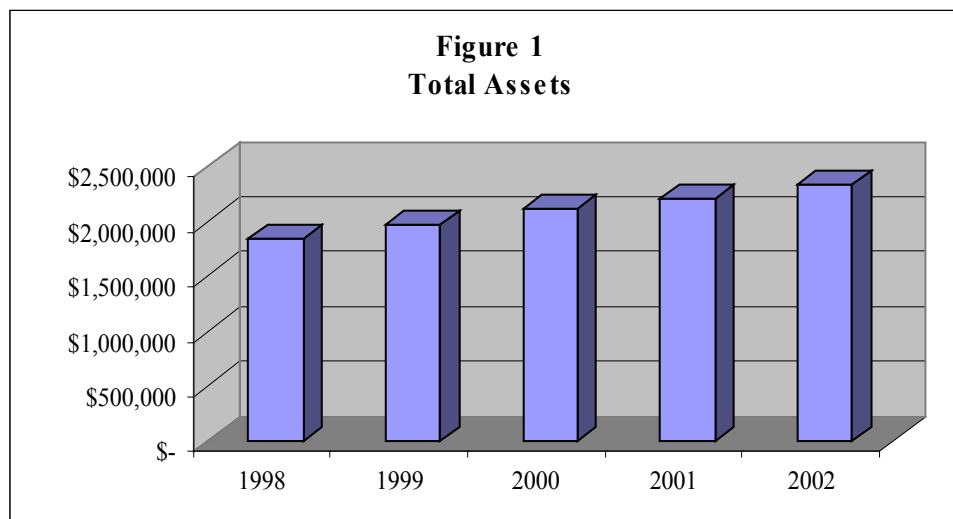
Apart from looking at absolute numbers, such as the increase or decrease in net assets (fund balances), this report will also calculate certain ratios, which are indicators of financial performance. These ratios can be used to look at the historical performance of the institution. In addition, these ratios can also be used to compare one institution to another institution, assuming that most institutions use generally recognized accounting procedures as set forth in Audits of Colleges and Universities a publication of the American Institute of Certified Public Accountants. However, caution should be exercised particularly at lower levels of detail because of differences in reporting.

The purpose of this report is to help educate faculty at Rutgers University about the financial status of their institution. 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 responsibilities 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. Table 1 shows the assets, liabilities and fund balances or net assets of the University.



In 1998 Rutgers had total assets of \$ 1.8 billion and the University's assets increased steadily through 2002. In 2002 the University reported total assets of \$2.3 billion in its Audited Financial Statement. Thus, over the five year period considered in this report Rutgers' assets increased by about 26.5 percent.

Figure 1 shows the total assets of Rutgers University. Total assets have been increasing reflecting the growth of both financial assets and physical assets i.e., growth of buildings and equipment. Table 1 shows the Statement of Net Assets for Rutgers University. The holdings of cash and cash equivalents are as reported in financial statements except for 2002. Before 2002 Commercial Paper which is an unsecured loan to a large business was counted as part of cash and cash equivalents. In the 2002 financial statements Commercial Paper is reported as part of investments resulting in a dramatic decline in the holdings of cash and cash equivalents. For consistency we have subtracted Commercial Paper from investments and added it to cash and cash equivalents as reported in Table 1. Holdings of cash and cash equivalents increased 104 percent with most of the increase (73 percent) coming between 1998 and 1999. Since 1999 holdings of cash and cash equivalents increased by about 18 percent.

Table 1
Statement of Net Assets
for year ending June 30
thousands of \$

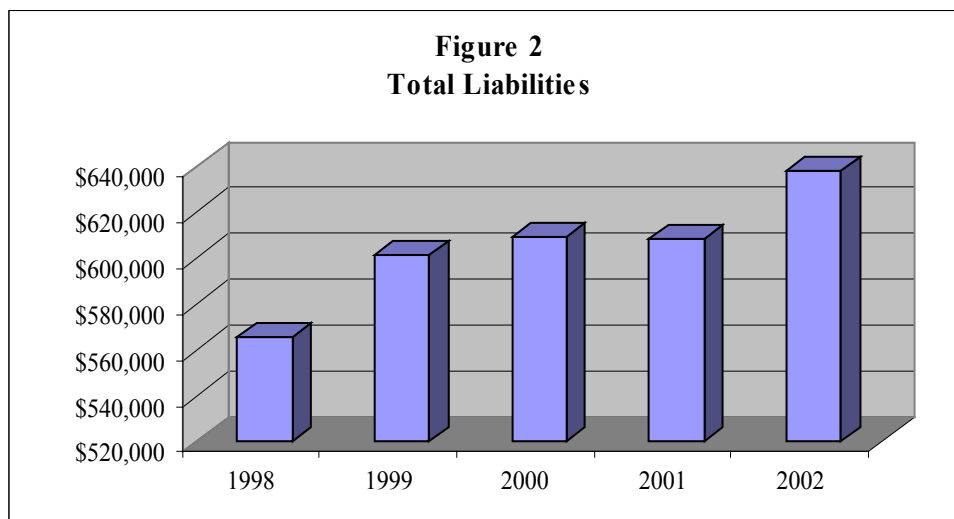
	1998	1999	2000	2001	2002
Assets					
Cash and Cash Equivalents	\$ 138,691	\$ 241,000	\$ 270,406	\$ 241,909	\$ 283,701
Investments	\$ 522,973	\$ 502,395	\$ 525,579	\$ 507,839	\$ 528,343
Accounts Receivable	\$ 42,215	\$ 45,136	\$ 62,425	\$ 59,114	\$ 59,406
Student Notes Receivable	\$ 36,051	\$ 35,678	\$ 35,710	\$ 36,547	\$ 36,393
Pledges Receivable	\$ -	\$ -	\$ 8,344	\$ 8,324	\$ 17,070
Inventories	\$ 4,444	\$ 4,403	\$ 5,116	\$ 3,724	\$ 4,015
Prepaid Expenses & Deferred Charges	\$ 9,253	\$ 10,173	\$ 11,100	\$ 12,387	\$ 5,813
Construction Costs Reimbursable	\$ 6,549	\$ 3,616	\$ 4,750	\$ 22,699	\$ 2,644
Property, Plant & Equipment	\$ 1,085,042	\$ 1,127,725	\$ 1,191,228	\$ 1,307,600	\$ 1,396,470
Total Assets	\$ 1,845,218	\$ 1,970,126	\$ 2,114,658	\$ 2,200,143	\$ 2,333,855
Liabilities					
Accounts Payable & Accrued Expenses	\$ 63,904	\$ 58,677	\$ 68,742	\$ 73,339	\$ 103,870
Deferred Revenues	\$ 20,417	\$ 22,118	\$ 26,681	\$ 29,118	\$ 32,325
Payroll Withholdings	\$ 2,837	\$ 3,281	\$ 6,667	\$ 6,117	\$ 6,958
Annuities Payable	\$ 4,740	\$ 5,200	\$ 5,821	\$ 6,011	\$ 6,486
Other Payables	\$ 10,759	\$ 10,384	\$ 17,690	\$ 21,957	\$ 1,228
Long-Term Liabilities	\$ 463,301	\$ 501,676	\$ 483,848	\$ 471,726	\$ 486,890
Total Liabilities	\$ 565,958	\$ 601,336	\$ 609,449	\$ 608,268	\$ 637,757
Fund Balances					
Unrestricted	\$ 243,379	\$ 262,096	\$ 284,044	\$ 289,015	\$ 269,294
Restricted					
Non-Expendable	\$ 148,892	\$ 158,826	\$ 189,066	\$ 185,782	\$ 182,578
Expendable	\$ 197,181	\$ 216,562	\$ 239,882	\$ 236,289	\$ 279,787
Net Investment in Plant	\$ 689,808	\$ 731,306	\$ 792,217	\$ 880,789	\$ 964,439
Total Net Assets	\$ 1,279,260	\$ 1,368,790	\$ 1,505,209	\$ 1,591,875	\$ 1,696,098
Total Liabilities and Net Assets	\$ 1,845,218	\$ 1,970,126	\$ 2,114,658	\$ 2,200,143	\$ 2,333,855

Table 1 also differs from the financial statements in that it consolidates the value of land, land improvements, equipment, buildings, intangible assets and construction in

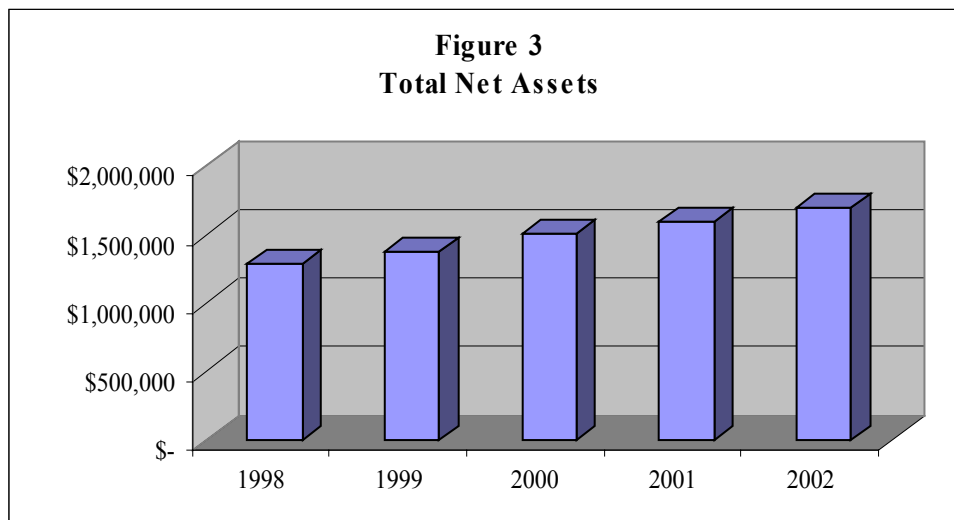
progress under the heading property, plant and equipment. Rutgers is somewhat unusual in its reporting of the value of plant and equipment net of depreciation. Most state universities have only started depreciating plant and equipment in fiscal year 2002. The fact that Rutgers has been depreciating its plant and equipment throughout the entire period considered in this report, allows for consistent reporting of the value of property, plant and equipment. From 1998 through 2002 the value of property, plant and equipment net of depreciation increased 28.7 percent.

Figure 2 shows the total adjusted liabilities of the University. Liabilities increased from \$566 million in 1998 to \$608 million in 2002. Table 1 also shows the liabilities for the University. It is difficult to compare changes in the various categories of liabilities across years because of the changes in reporting format. It is likely that some of the changes in individual categories are due in part to reporting changes required by GASB 35. For example, there was a major increase accounts payable and accrued expenses in 2002. Most of the increase was due to a reported decrease in other payables which went from \$29.5 million in 2001 to \$1.2 million in 2002. Some of this decrease in other payables was also transferred to deferred revenue (\$14,000).

The most notable change in liabilities is in the category of long term liabilities. Long term liabilities consist primarily of bonds and capital leases. In 2001 the University reported long term liabilities of \$608.3 million. In the 2002 financial statement when it restated its 2001 assets and liabilities the assets were the same but the liabilities reported for 2001 had increased by \$8.8 million. In all likelihood this increase in liabilities is probably due to reporting changes required by GASB 35. The increased liability has the effect of reducing the reported net assets of the University. This reduction in net assets however, does not reflect a decline in the wealth of the institution relative to its position in previous years and therefore can be misleading. In order to have a consistent comparison of the University's assets, liabilities and net assets we have reduced the liabilities reported in 2002 by the \$8.8 million. Thus in 2002 we report in Table 1 that the University has total liabilities of \$638 million rather than the \$647 million reported in the 2002 financial statement.



Net assets are the difference between assets and liabilities and represent the wealth of the institution. Therefore net assets are an important indicator of the financial health of an institution. In the past these net assets were referred to as fund balances. There has been a significant increase in the net assets of the institution as seen in Figure 3.



Total net assets increased from \$ 1.3 billion in 1998 to \$1.7 billion in 2002. In 2002 the University reported net assets of \$1,687.3 million where as Table 1 shows net assets of \$1,696.1 million. Since the reported net financial assets of the University did not change for 2001 as reported in the 2002 financial statement the increased liability referred to earlier reduced net assets reported for property, plant and equipment. The number reported as net investment in plant in the 2002 financial statement is the \$955.6 million. The \$955.6 million plus \$8.791 million which represents the reduction in liability discussed earlier equals the \$964.4 million shown in Table 2. Increases in net assets represent an increase in the University's wealth and this occurs when revenues exceed expenses or when the University receives money from governmental or private sources to finance capital projects.

The increase in total net assets of the University represents an increase in wealth for the University. However, state universities often receive two pots of money. One consists of capital funds for building and renovation and the other consists of operating funds for example state subsidy. Money that is received for capital projects is often times restricted and cannot be used for operating i.e., paying for salaries and benefits. Thus, while it can appear that a university is increasing its wealth and should have more resources available to expend for operations, this may not be the case.

If the 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. However, it should be noted that even when buildings are constructed using capital funds there are clear implications for operating budgets in the future. As universities increase their square footage they will be required to spend additional funds on maintenance and utilities thereby increasing their operating expenses.

Figure 4 shows several key ratios. These key ratios are also reported in Table 2. First is the ratio of current assets to current liabilities. Current assets consist of unrestricted cash and cash equivalents, inventories, receivables and pledges due within a year, investments that mature within one year and other short term assets. Assets such as restricted cash and cash equivalents and restricted investments, unrestricted investments that mature in more than one year, receivables and pledges deemed collectable in more than one year and plant and equipment are non-current assets. Current liabilities are all liabilities payable within one year as well as deferred revenues which consist primarily of tuition collected in one fiscal year that pays for services offered in a subsequent fiscal year. Liabilities that are not due during the current year are non-current liabilities.

Table 2
Ratios of Assets to Liabilities
for year ending June 30

	1998	1999	2000	2001	2002
Current Ratio	2.25	2.46	2.43	2.62	2.14
Non-current Ratio	3.45	3.41	3.68	3.92	4.16
Ratio of Fixed Assets to Debt	2.34	2.25	2.46	2.77	2.87

With the new reporting structure the mandated by GASB 35 institutions must divide assets and liabilities into current assets and liabilities and non-current assets and liabilities. However, before 2001 no such division was required. Thus to calculate the ratio for 2001 and 2002 we use the reported current assets and liabilities. For the years 1998-2000 we take the ratio of the assets to the liabilities reported in the Current Fund which assumes that all assets and liabilities in the Current Fund are short-term because they represent the operating funds for the institution. This means that the ratios for 2001 and 2002 clearly the most accurate and not strictly comparable to the ratios for previous years.

The ratio of current assets to current liabilities increased from 2.25 in 1998 to 2.62 in 2001 and then declined to 2.15 in 2002. A current ratio of 2.15 implies that the University has current assets to cover 215 percent of its current liabilities. Some of the increase in the reported current ratio for 2001 is due to different method of calculating

current assets and liabilities. Using the data reported for the Current Fund in the 2001 financial statement, the current ratio would have been 2.59. There is no exact target for a current ratio although clearly the number should be greater than one and not much greater than two. Too large a current ratio imposes an opportunity cost on a university.

Figure 4 also shows the ratio of non-current assets to non-current liabilities. Non-current assets and liabilities are calculated by subtracting current assets and liabilities from total assets and liabilities. The ratio of non-current assets to non-current liabilities has generally been increasing. In 1998 the ratio was 3.45 and by 2002 it had risen to 4.16.

Another indicator of financial health is the ratio of fixed assets to long-term debt, which is also shown in Figure 4. Again this ratio has generally been rising increasing from 2.34 in 1998 to 2.87 in 2002.

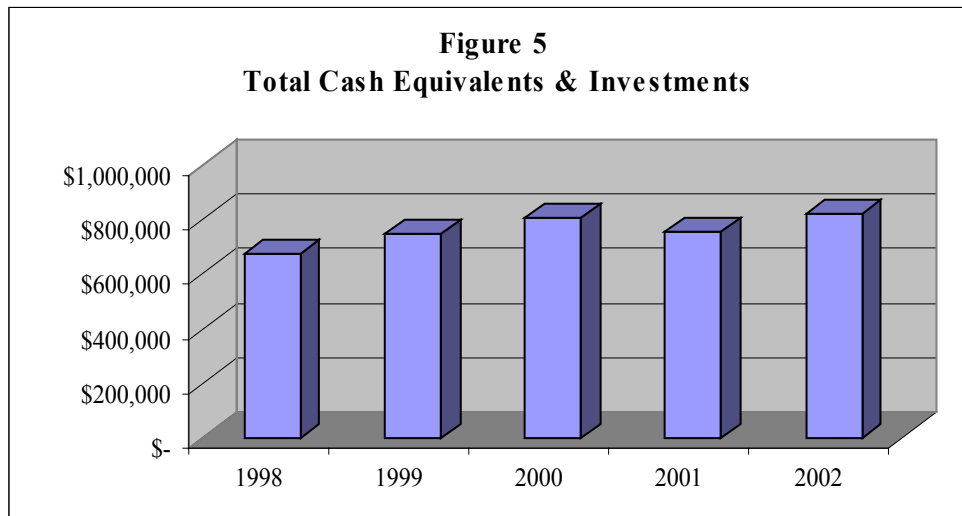
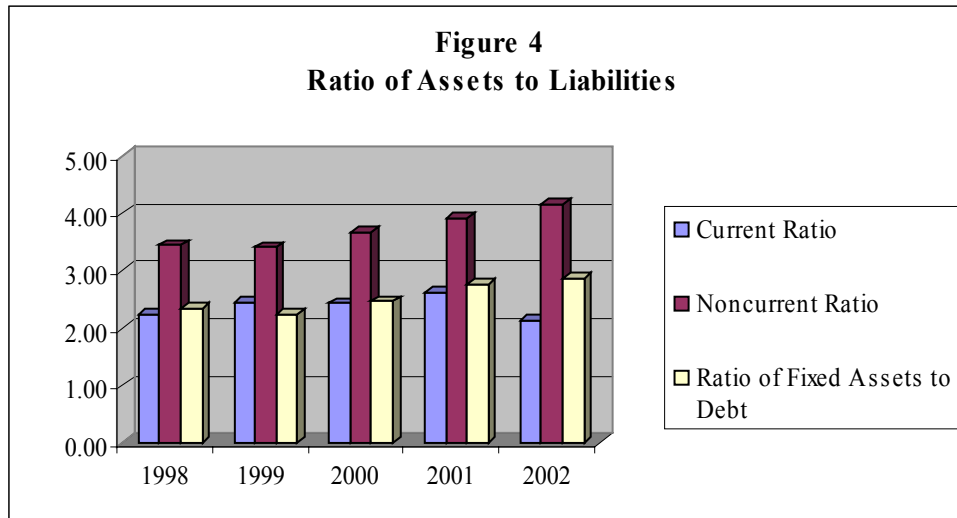


Table 3
Cash Equivalents and Investments
for year ending June 30
thousands of \$

	1998	1999	2000	2001	2002
Cash Equivalents					
Commercial Paper	\$ 116,503	\$ 202,380	\$ 164,211	\$ 158,937	
Government Agency Discount Notes			\$ 34,711	\$ 6,999	\$ -
Money Market Funds	\$ 29,596	\$ 35,640	\$ 55,057	\$ 72,807	\$ 79,900
Treasury Bills	\$ 937				
Repurchase Agreements	\$ 1,289	\$ 6,164	\$ 21,408	\$ 7,168	\$ 21,287
Total Cash Equivalents	\$ 148,325	\$ 244,184	\$ 275,387	\$ 245,911	\$ 101,187
Investments:					
Commercial Paper					\$ 187,741
Demand Notes					\$ 36,635
Federal & State Government Securities	\$ 222,304	\$ 167,776	\$ 228,261	\$ 212,786	\$ 187,841
Corporate Equity Securities	\$ 172,305	\$ 204,477	\$ 232,726	\$ 211,907	\$ 204,283
Corporate Debt Securities	\$ 42,601	\$ 48,146	\$ 41,381	\$ 59,726	\$ 57,651
Asset-backed Securities			\$ 23,211	\$ 23,420	\$ 6,360
Mortgage-backed Securities	\$ 85,763	\$ 81,996			\$ -
Real Estate					\$ 441
Total Investments	\$ 522,973	\$ 502,395	\$ 525,579	\$ 507,839	\$ 680,952
Mutual Funds:					
Cash Equivalents					\$ 15,012
Domestic Equities					\$ 17,168
Domestic Bonds					\$ 2,952
Total Mutual Funds	\$ -	\$ -	\$ -	\$ -	\$ 35,132
Total Cash Equivalents & Investments	\$ 671,298	\$ 746,579	\$ 800,966	\$ 753,750	\$ 817,271

Table 3 shows the cash equivalents and investments of Rutgers University and Figure 5 shows the trend in total cash equivalents and investments. In general, the value of the University's cash equivalents and investments increased only slightly from 1998 through 2002. Cash equivalents increased from \$148.3 million in 1998 to \$275.3 million in 2000. Between 2000 and 2001 there was a decline in cash equivalents and again in 2002 there was a substantial decline in cash equivalents. Virtually the entire decline in 2002 was due to reclassifying commercial paper from being a cash equivalent to an investment.

Over the period from 1998 to 2002 investments increased 30.2 percent. However, most of that increase reflects the reclassification of commercial paper. Taken as a whole the University's cash equivalents and investments increased a modest 21.4 percent with most of that increase (19.3 percent) occurring before 2001. Clearly given the declines in the stock market and record low interest rates, the rather modest gains, particularly since 2000, are not particularly surprising. What is somewhat surprising is the fact that between 1998 and 2000 investments only increased 0.5 percent while the value of cash equivalents increased 86 percent.

Table 4 shows the total debt as well as interest and principal payments. In 1999 the University had a moderate increase in debt. Debt levels then declined for the following two years. Then in 2002 there was another moderate increase in debt due primarily to an increase in capitalized lease obligations. Figure 6 shows changes in long-term debt.

Table 4
Debt and Debt Service
for year ending June 30
thousands of \$

	1998	1999	2000	2001	2002
Notes Payable	\$ 2,019	\$ 1,873	\$ 1,723	\$ 1,677	\$ 1,627
Bonds Payable	\$ 396,335	\$ 433,300	\$ 419,145	\$ 404,315	\$ 377,129
Capitalized Lease Obligations	\$ 64,947	\$ 66,503	\$ 62,980	\$ 74,525	\$ 116,925
Total Debt	\$ 463,301	\$ 501,676	\$ 483,848	\$ 480,517	\$ 495,681
Principal Paid on Debt & Leases	\$ 14,906	\$ 14,878	\$ 16,506	\$ 17,186	\$ 17,295
Interest Payments	\$ 26,442	\$ 26,703	\$ 26,855	\$ 26,705	\$ 23,577

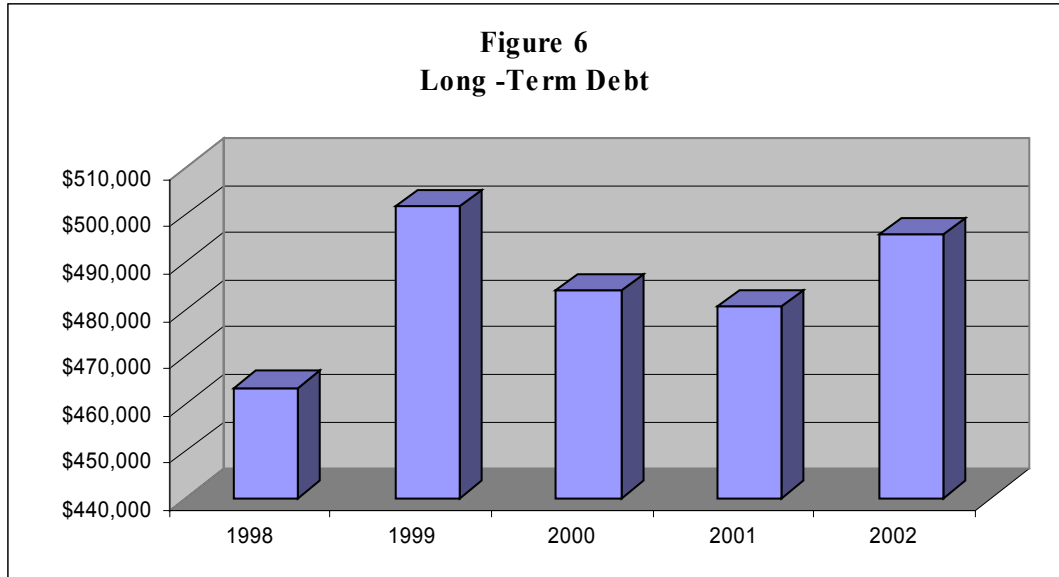
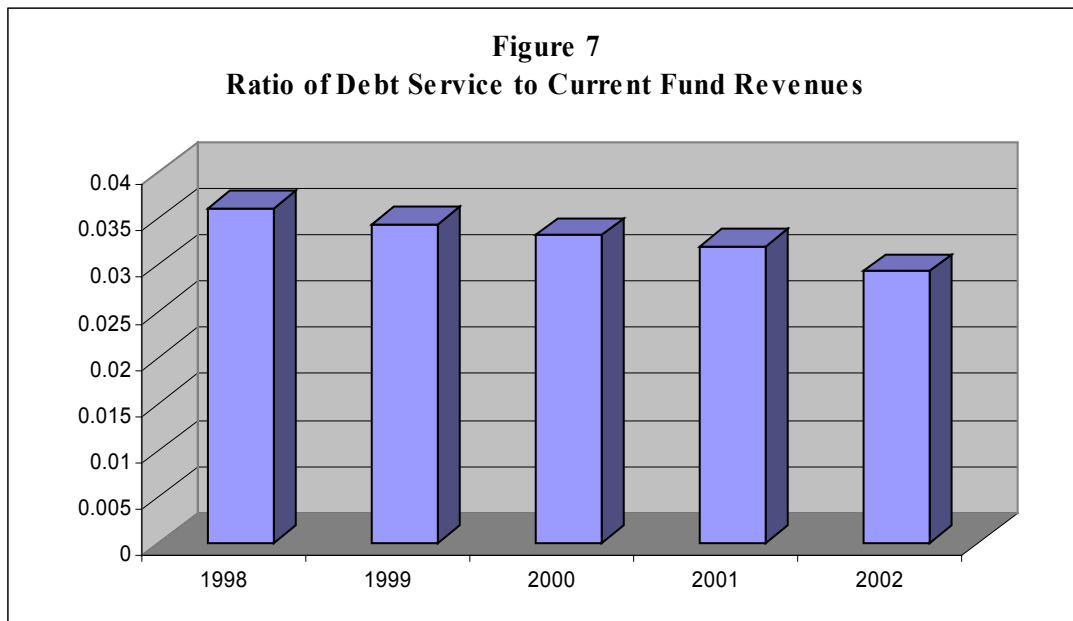


Table 4 also shows principal and interest payments. Generally, interest and principal payments for Rutgers have been fairly stable which is consistent with the relatively stable level of debt for the University.



One measure of the ability of an institution to meet its debt payments is the ratio of debt service to current fund revenues. Figure 7 shows that the ratio of debt service to current fund revenues has generally been declining. A decline in this ratio means that the University has increased its ability to make principal and interest payment which

indicates that with respect to meeting its debt payments, the University has improved its financial position.

Table 5
Plant and Equipment
for year ending June 30
thousands of \$

	1998	1999	2000	2001	2002
Land	\$ 33,694	\$ 34,609	\$ 35,682	\$ 38,052	\$ 38,608
Land Improvements	\$ 44,955	\$ 55,343	\$ 66,478	\$ 80,324	\$ 157,970
Buildings	\$ 1,175,638	\$ 1,206,199	\$ 1,274,450	\$ 1,333,111	\$ 1,349,156
Equipment	\$ 397,241	\$ 425,612	\$ 453,354	\$ 483,448	\$ 522,948
Total	\$ 1,651,528	\$ 1,721,763	\$ 1,829,964	\$ 1,934,935	\$ 2,068,682

Table 5 shows the University's investments in plant and equipment. The numbers in the table represent the original cost as opposed to market value or replacement cost. In 2002 the University apparently revalued its equipment because in the 2001 financial statement they originally reported the cost of equipment at \$483.4 million as shown in Table 4 but in the 2002 financial statement they report equipment cost at \$450.4 million. There is no explanation for the change in the valuation of equipment in the notes to the financial statement. Again to get a consistent estimate we calculated the cost of equipment for 2002 as the cost in 2001 plus additions minus retirements. The numbers show a steady increase in the value of plant and equipment when valued at cost.

Total Net Assets

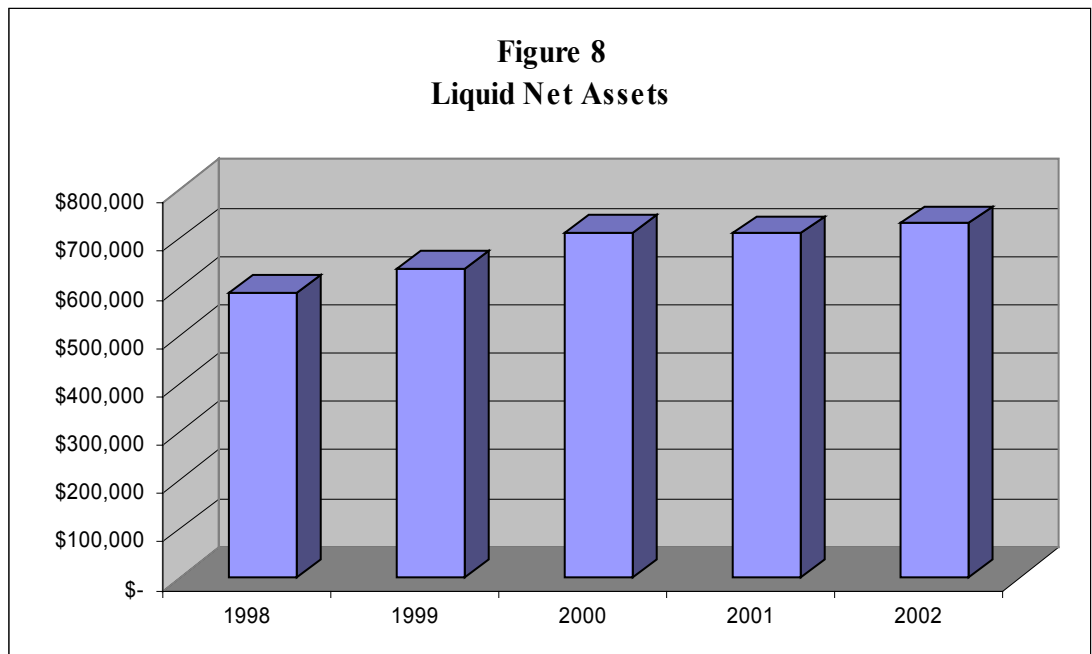
In for profit businesses the difference between assets and liabilities is referred to as owner's equity. In theory if a business were to sell off all of its assets and pay off all claims against the business, the amount remaining would be the owner's claims on the business's resources. In a non-profit organization, the difference between assets and liabilities has traditionally been referred to as a fund balance. However, after implementation of GASB 35 the difference between assets and liabilities is now referred to as net assets.

Net assets represent the net accumulation of a university's assets over a period of time. A large portion of these net assets consist of the value of land, buildings, books and journals and equipment owned by the college. Beginning in 2002 with GASB 35 universities are required to show accumulated depreciation on their balance sheets for certain real assets such as buildings and some equipment. Unlike most other public universities Rutgers has been subtracting accumulated depreciation from the value of its plant and equipment. Taking into account accumulated depreciation significantly reduces the net assets of an institution. Whether this diminution of net assets represents a real decline in the wealth of an institution is questionable.

For private companies depreciation represents the cost of “using up” plant and equipment. However, in universities most of the buildings and a significant part of the equipment is paid for by governmental appropriations or private gifts. Thus universities have a source of financing replacement of worn out buildings and equipment that is not available to private business. In the case of Rutgers, since the University has been reducing the value of its plant and equipment by claiming depreciation, it should have accumulated a reserve of cash that should be available to the University for replacing buildings and equipment or for some other purpose.

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. These financial assets would not include cash that has been accumulated as a result of claiming depreciation on plant and equipment.

Figure 3, presented earlier in this report, shows total fund balances also referred to as net assets for Rutgers University. 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 8 shows the University’s net assets excluding investment in plant i.e., liquid net assets. Figure 8 generally shows a significant growth in liquid assets between 1998 and 2002. In 1998 Rutgers had liquid assets of \$589.5 million and by 2002 this figure had rise to \$731.7 million an increase of 24.1 percent.



Restricted and Unrestricted Net Assets

Restricted net assets are assets net of related liabilities held by the University that are designated for specific purposes by external entities, either government agencies or private donors. Unrestricted net assets are assets net of related liabilities that can be spent at the discretion of the institution. Clearly, unrestricted net assets give universities more flexibility than restricted net assets. However, one should not assume that just because an asset is restricted that it cannot be used for reallocation. For example a university may be spending a significant amount of unrestricted funds on scholarships and then replaces those funding with endowed scholarships. In this case, there would be no change in unrestricted funds but there would be an increase in restricted funds. However, the unrestricted funds that were being used for scholarships have now been freed up and are available for reallocation.

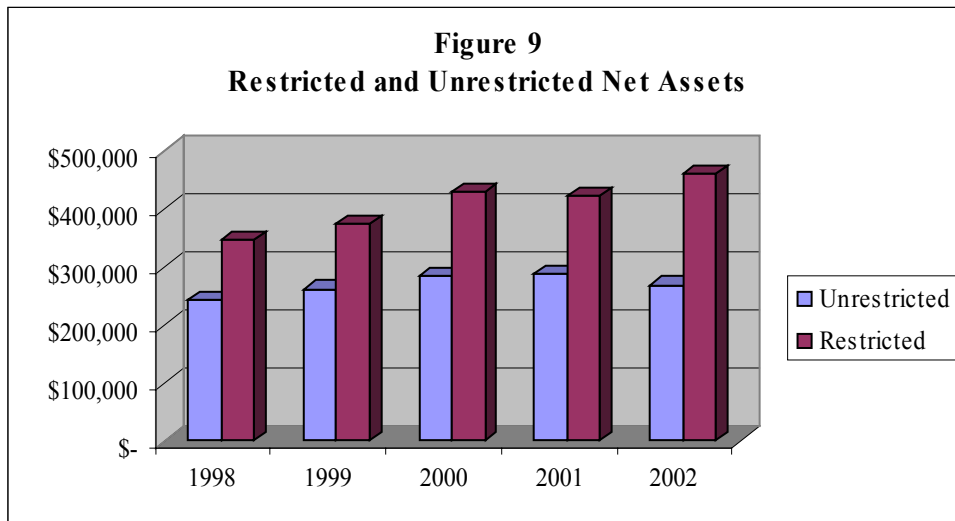
Table 6
Restricted and Unrestricted Net Assets
for year ending June 30
thousands of \$

	1998	1999	2000	2001	2002
Unrestricted	\$ 243,379	\$ 262,096	\$ 284,044	\$ 289,015	\$ 269,294
Restricted	\$ 346,073	\$ 375,388	\$ 428,948	\$ 422,071	\$ 462,365
Net Investment in Plant	\$ 689,808	\$ 731,306	\$ 792,217	\$ 880,789	\$ 964,439
Total Net Assets	\$ 1,279,260	\$ 1,368,790	\$ 1,505,209	\$ 1,591,875	\$ 1,696,098

Table 6 shows the net assets divided into restricted and unrestricted funds. From 1998 to 2001 there were steady increases in unrestricted net assets. In 2002 there was a decline in unrestricted net assets. Restricted net assets increased from 1998 to 2000 and then dropped slightly in 2001 before rising again in 2002. . Figure 9 shows the changes in unrestricted and restricted net assets.

The University in its Management Discussion and Analysis (MDA) notes that unrestricted assets can be used by the institution for any lawful purpose. However, the MDA also states that all of the unrestricted net assets have been designated by the governing boards or management for specific purposes. Some of these designations may result from funds being collected by special fees. This type of statement is misleading in the sense that all of the designated fees are the result of board or management policy and that policy can be changed. Few institutions have funds that are undesignated. The point that faculty need to understand is that current policies with respect to unrestricted net assets reflect the priorities of the governing board and/or management and may not reflect the priorities of faculty. While faculty cannot collectively bargain over the specific designation of unrestricted net assets collective bargaining can cause the

governing board or management to change its priorities resulting in the reallocation of these funds



Expendable Net Assets:

In addition to dividing net assets between restricted and unrestricted, net assets can also be categorized as expendable or non-expendable. Expendable net assets consist of assets that legally could be used for operations or plant expenditures. Non-expendable net assets are funds that would not be spent for operations, for example the endowment fund. Before GASB 35 universities, including Rutgers University presented their balance sheets by fund group. Universities generally have five fund groups: current funds, loan funds, endowment and similar funds, plant funds and agency funds. Endowment funds generally have three categories: endowment, quasi-endowments and term endowments, life income and annuity funds. Plant funds are generally divided into four categories unexpended plant funds, funds for renewal and replacement, funds for the retirement of indebtedness and investment in plant net of debt. Given these categories expendable balances are normally calculated by taking the sum of current funds, quasi-endowments, unexpended plant funds, funds for renewal and replacement, and funds for the retirement of indebtedness.

Quasi-endowments are funds that the Board of Trustees set aside to be used in the form of an endowment. These funds along with unrestricted plant funds are generally accumulated by transferring funds from current funds. As mentioned previously these funds are available for the University to spend for any lawful purpose which means that the University is not obligated to treat funds in a quasi-endowment as if they were an endowment nor are they obligated to spend designated plant funds on capital projects.

Table 7 shows expendable and non-expendable net assets. Expendable net assets at the University have increased steadily from 1998-2002. In 1998 expendable net assets were \$440.6 million in 1998 and reached \$549.1 million in 2002 an increase of 25

percent. Non-Expendable net assets increased until 2000 and have declined in the past two years. Non-Expendable net assets consist of the University's endowment and presumably this decline is due to the declines in the stock market and record low interest rates. Nevertheless there was a 23 percent increase in non-expendable balances from 1998-2002. Figure 10 also shows expendable and non-expendable balances.

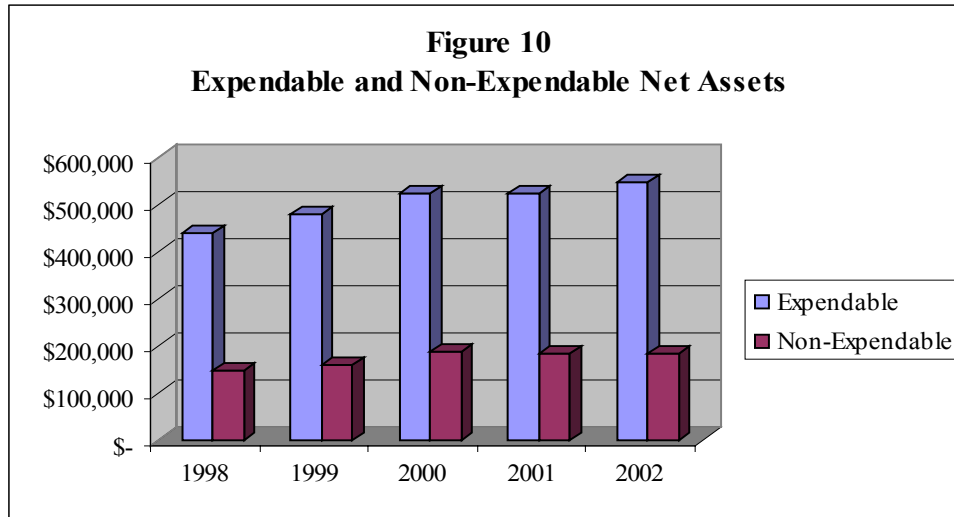


Table 7
Expendable and Non-Expendable Net Assets
for year ending June 30
thousands of \$

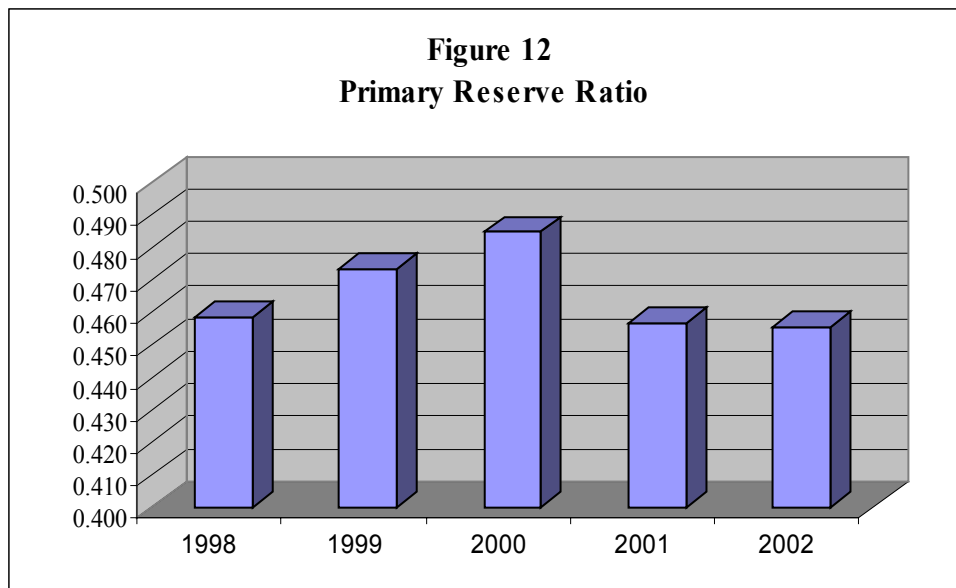
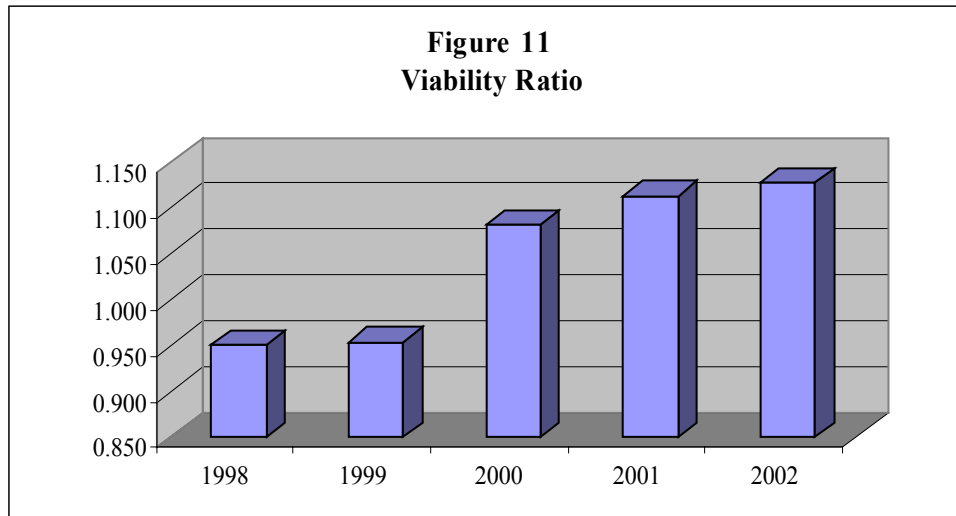
	1998	1999	2000	2001	2002
Expendable	\$ 440,560	\$ 478,658	\$ 523,926	\$ 525,304	\$ 549,081
Non-Expendable	\$ 148,892	\$ 158,826	\$ 189,066	\$ 185,782	\$ 182,578
Liquid Assets	\$ 589,452	\$ 637,484	\$ 712,992	\$ 711,086	\$ 731,659
Debt	\$ 463,301	\$ 501,676	\$ 483,848	\$ 471,726	\$ 486,890
Operating Expenses & Interest	\$ 960,841	\$ 1,010,985	\$ 1,080,696	\$ 1,150,197	\$ 1,205,652

Ratios:

Viability Ratio	0.951	0.954	1.083	1.114	1.128
Primary Reserve Ratio	0.459	0.473	0.485	0.457	0.455

Table 7 also shows two ratios, which are commonly calculated as indicators of financial health. The first is known as the viability ratio, which is the ratio of expendable net assets to long-term debt. The viability ratio increased over the entire period from 1998-2002. In 1998 the viability ratio was 0.951, which meant that the University had sufficient expendable net assets to pay 95.1 percent of its long-term debt. In 2002 the

viability ratio was 1.128 which meant the University had sufficient expendable net assets to pay 112.8 percent of its debt. The changes in Rutgers University's viability ratio can also be seen in Figure 10.



The second ratio presented in Table 7 is the primary reserve ratio, which measures the ratio of expendable net assets to expenses. In the past this ratio was calculated by dividing expendable balances by current fund expenditures and mandatory transfers. However, with GASB 35 and the new reporting format, which eliminated the current fund reporting the ratio is now calculated by dividing expendable balances by operating expenses and interest payments. The primary reserve ratio shows a pattern of increasing between 1998 and 2000 and then declining in 2001 and then increasing again slightly in 2002. A primary reserve ratio of 0.455 implies that the University has enough expendable net assets to meet 45.5 percent of its operating expenses. Figure 12 shows that the primary reserve ratio rose between 1998 and 2000 and then declined between

2000 and 2002. However, even with the decline the overall level of the primary reserve ratio is still fairly high and thus the decline in the last two years is little cause for concern.

In summary, in 2002 Rutgers University had total net assets of \$1.7 billion with \$731.7 million in liquid assets. These liquid assets were divided between \$549.1 million in expendable funds and \$182.5 million in non-expendable funds. In general, an analysis of the University's Statement of Net Assets suggests that since 1998 the University has moderately improved its financial flexibility.

What is the income and expenditures of the University?

Net Income

The flow of wealth into a university is referred to as revenue and other additions. For most state universities there are five major sources of revenue: 1) tuition and fees, 2) state subsidy, 3) endowments, 4) grants, gifts and contracts and 5) sales which include fees collected by auxiliary enterprises such as dormitories and bookstores. In order for a university to carry out its mission it is necessary for it to purchase certain resources, which represent an outflow of resources from the university. This outflow is referred to as expenditures and other disbursements. These expenditures and disbursements consist of wages, salaries and benefits as well as expenditures for purchases of goods and services from external vendors.

In the past, this flow of resources was accounted for in the Statement on Changes in Fund Balances, which was the closest thing that a university had to an income or profit and loss statement that would be found in a for profit business. In fact, the change in total fund balances was in many ways analogous to the concept of net income or profit that one would encounter in a for profit enterprise. There were, however, some subtle differences in fund accounting compared to accounting in for profit businesses. These differences showed up in the way that certain capital expenditures and debt repayment were treated in fund accounting as well as how depreciation and appreciation of physical assets were treated in fund accounting. Another unique feature of fund accounting was the treatment of financial aid. A final unique feature of fund accounting was the use of inter-fund transfers.

Before GASB 35 when universities provided students with stipends, tuition grants, fellowships and other forms of financial aid they recorded this as an expenditure in the Statement of Changes in Fund Balances or the Statement of Changes in Current Funds. The university treated the granting of financial aid as if they had written a check to a student who then used that money to pay for tuition and fees. To counterbalance the fact that universities counted financial aid as an expense they also added it to the revenue side where it showed up as part of tuition and fees. In for profit business accounting a discount would not be considered an expense. Rather it would be treated as a reduction in revenue. To get a true picture of actual revenues and expenses student aid should be subtracted from tuition and fees in which case it would not be counted as an expense. With the implementation of GASB 35 aid that does not flow directly to students will now

be treated as a reduction in revenue and only that portion of student aid that goes directly to students will be treated as an expense.

Another example of how fund accounting differed from for profit accounting relates to the way in which universities treated capital additions. Before GASB 35 the Statement of Changes in Fund Balances treated capital grants from the state as revenue. If the state gives an institution money to construct a building this is not actually revenue. When the university spends that money for construction it is not an expense. The reason it is not considered as an expense is that the building wears out over a period of time. The cost of using a building should be taken into account by deducting depreciation. To count construction costs as an expense and then to depreciate a building would be double counting. Business accounting rules require that expenses be recognized when they are incurred which is the case of a building is over the life of the asset. GASB 35 now requires that universities count depreciation as an expense.

When a university is required to show depreciation as an expense this will reduce net income in comparison to earlier years. However, faculty should not be misled by the decline in net income caused by counting depreciation as an expense. While depreciation may be a cost, it is important to remember that it does not represent an outflow of cash from the institution.

Before GASB 35 the Statement of Changes in Fund Balances actually listed revenues and other additions. It also listed expenditures and other deductions. To get a true picture of actual revenues and expenses for the years 1998-2002 one should eliminate the non-expense portion of student aid, expenditures on plant, indirect costs recovered, matured annuity and life income funds and retirement of debt from both the revenue and the cost side. While these adjustments do not affect the change in net assets (the net income of the university) they do give a better picture of the actual revenues and expenses of the University.

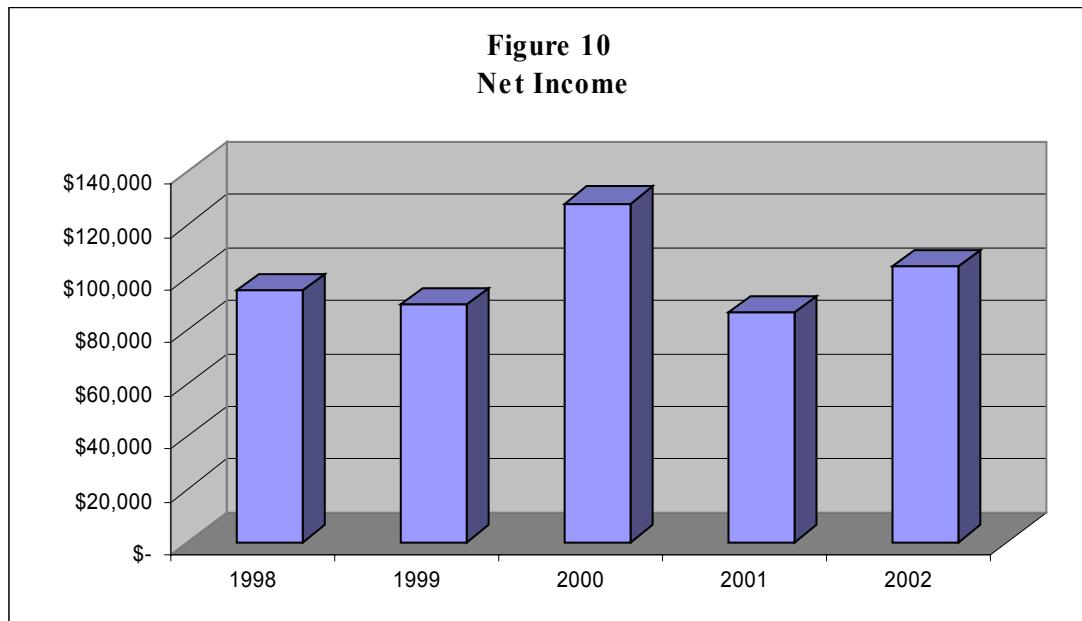
Table 8 shows the consolidated position of the University for the years 1998-2002. For 1998-2001 in Table 8 we report as total revenue the total revenues and additions from the Statement of Changes in Fund Balances minus indirect costs recovered and 0.91 of total student aid. This assumes that about 9 percent of student aid is paid directly to students which is consistent with the number reported for 2001 in the 2002 financial statement. For 2002 we calculate total revenue as total operating revenues, plus total non-operating revenues, plus capital appropriations, capital grants and gifts, and additions to permanent endowments. Over the period from 1998 to 2002 total revenues increased 26.8 percent.

For 1998-2001 in Table 8 we report as total expenses the total expenditures and other deductions plus non-capitalized expenditures minus expended for plant facilities, debt retirement, indirect costs recovered, 0.91 of student aid, matured annuity and life income funds and capital charged to current funds. Total expenses for 2002 are calculated by taking the sum of operating and non-operating expenses. From 1998-2002 Expenses increased by 28.5 percent.

Table 8
Revenues and Expenses
thousands of \$
for year ending June 30

	1998	1999	2000	2001	2002
Revenues and Other Additions					
Educational & General Revenues	\$ 700,893	\$ 734,573	\$ 785,751	\$ 828,596	
Indirect Costs Recovered	\$ (23,940)	\$ (25,646)	\$ (27,820)	\$ (29,481)	
Adjustment for Student Aid	\$ (173,717)	\$ (180,214)	\$ (186,870)	\$ (195,761)	
Auxiliary Revenues	\$ 138,771	\$ 146,216	\$ 158,547	\$ 165,005	
Federal Grants & Contracts	\$ 215,121	\$ 225,564	\$ 237,940	\$ 240,842	
State & Municipal Grants & Contracts	\$ 56,362	\$ 60,428	\$ 66,504	\$ 78,326	
Gifts, Private Grants & Contracts	\$ 65,541	\$ 76,181	\$ 95,679	\$ 133,569	
State Capital Appropriations	\$ 22,203	\$ 18,253	\$ 15,351	\$ 23,813	
Federal Advances	\$ 175	\$ 158	\$ 116	\$ 188	
Investment Income	\$ 18,933	\$ 19,129	\$ 20,220	\$ 19,372	
Student Tuition & Fees	\$ 4,182	\$ 4,218	\$ 4,285	\$ 4,356	
Net Increase in Fair Value of Investments	\$ 24,048	\$ 9,521	\$ 30,749	\$ (39,647)	
Other Sources	\$ 7,228	\$ 12,134	\$ 8,319	\$ 7,685	
Total Revenues	\$ 1,055,800	\$ 1,100,515	\$ 1,208,771	\$ 1,236,863	\$ 1,339,054
Expenditures and Other Deductions					
Educational & General Expenditures	\$ 945,748	\$ 999,274	\$ 1,066,673	\$ 1,130,812	
Auxiliary Enterprise Expenses	\$ 116,386	\$ 122,269	\$ 133,096	\$ 144,467	
Refunds to Grantors	\$ 351	\$ 228	\$ 479	\$ 332	
Administrative & Collection Costs	\$ 484	\$ 638	\$ 702	\$ 757	
Disposal of Plant Facilities	\$ 1,012	\$ 1,136	\$ 1,087	\$ 1,066	
Depreciation Expense	\$ 58,049	\$ 60,205	\$ 63,561	\$ 65,449	
Interest on Debt	\$ 26,442	\$ 26,703	\$ 26,855	\$ 26,705	
Other Deductions	\$ 3,284	\$ 228	\$ 145	\$ 464	
Non Capitalized Plant & Equipment	\$ 9,310	\$ 10,139	\$ 11,414	\$ 10,602	
Capital Charged to Current Funds	\$ (26,508)	\$ (29,621)	\$ (36,446)	\$ (34,696)	
Adjustment for Student Aid	\$ (173,717)	\$ (180,214)	\$ (186,870)	\$ (195,761)	
Total Expenses	\$ 960,841	\$ 1,010,985	\$ 1,080,696	\$ 1,150,197	\$ 1,234,831
Increase in Net Assets	\$ 94,959	\$ 89,530	\$ 128,075	\$ 86,666	\$ 104,223

The change in net assets is the difference between total revenue and total expenses and is shown in Table 8 and also in Figure 10. The change in net assets is in effect the profit earned by the University. Universities like all organizations need to earn profit in order to accumulate reserves to deal with unforeseen contingencies and to allocate fund for expansion and replacement of facilities. However, the amount of profit that universities need for these purposes is a matter of policy. Of the five years of data reviewed in this report Rutgers has had an average net income of \$101 million per year.



In Table 9 we present two numbers for net income in 2001. The first is calculated as described above using the 2001 financial statement. The second number for net income is based on the restated earnings for 2001 presented in the 2002 financial statement. The difference between these two numbers reflects the impact of changes in financial reporting brought about by GASB 35. In addition, Table 9 breaks down net income between net income earned from educational and general activities and net income earned from auxiliaries.

As expected most of the University's net income comes from its educational and general activities. The average net income for educational and general activities was \$80.5 million. As indicated in Table 9 the brought about by GASB 35 actually increased the net income from educational and general activities by \$6.4 million. Figure 11 shows net income from educational and general activities.

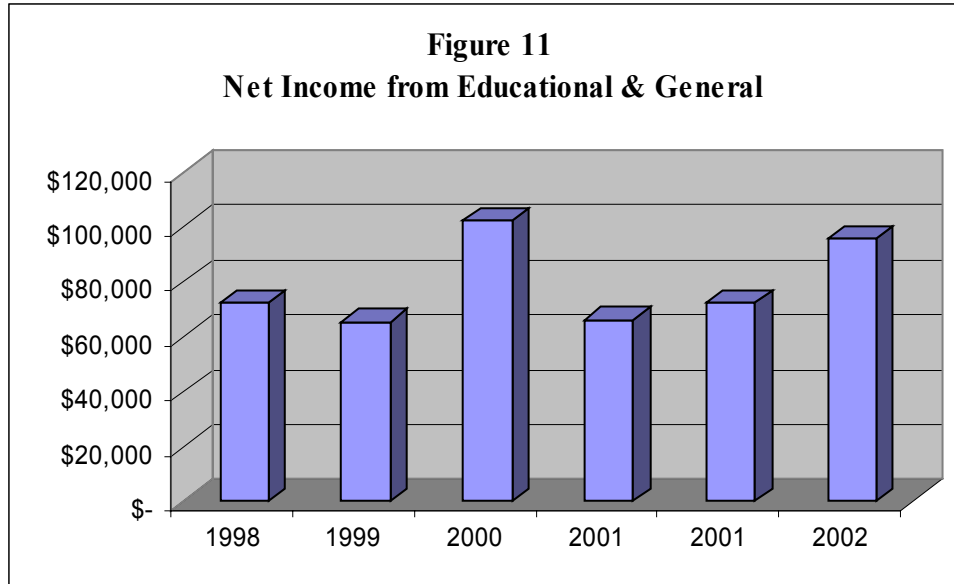
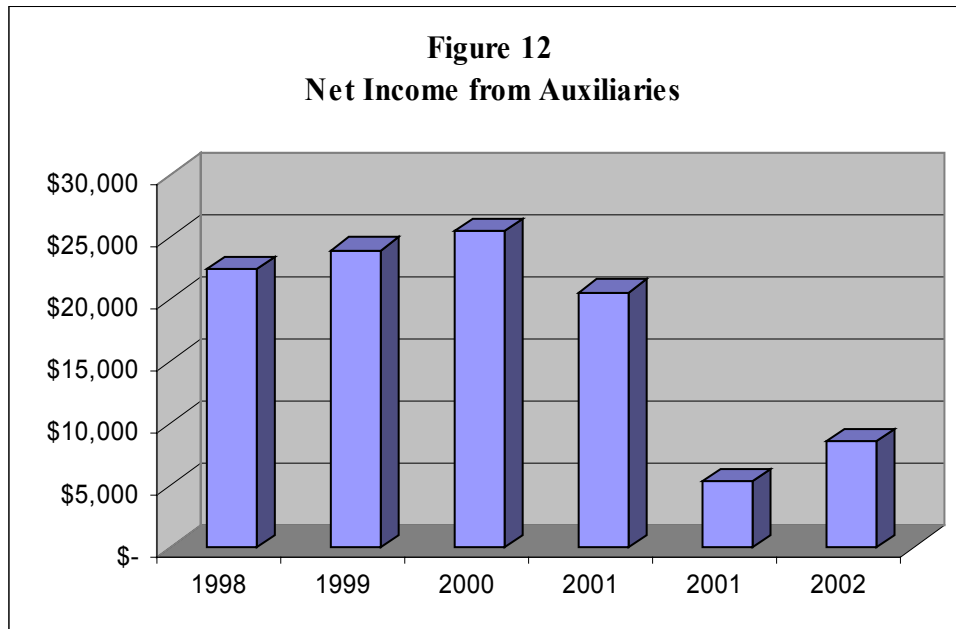


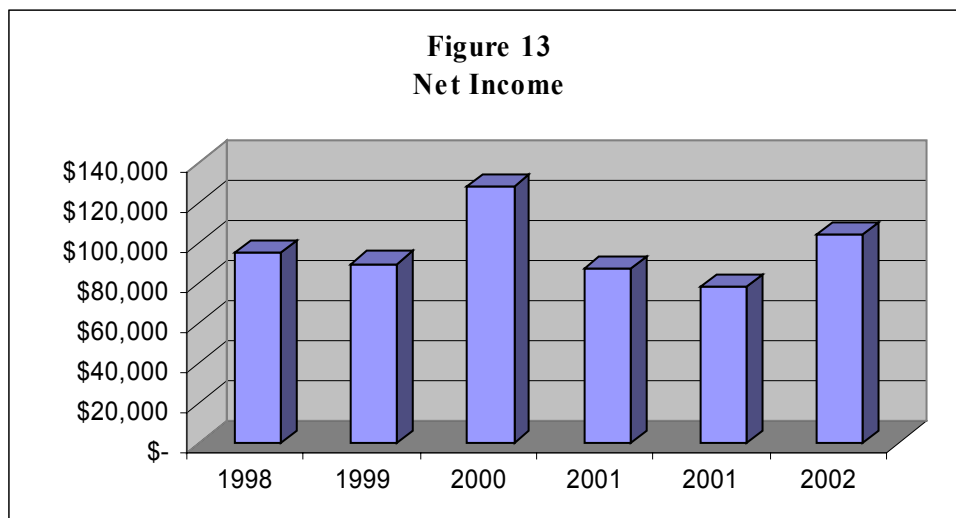
Table 9
Revenues and Expenses
thousands of \$
for year ending June 30

	1998	1999	2000	2001	2001	2002
Revenue from Educational & General	\$ 917,029	\$ 954,299	\$1,050,224	\$ 1,071,858	\$ 1,122,447	\$1,186,930
Expenses from Educational & General	\$ 844,455	\$ 888,716	\$ 947,600	\$ 1,005,730	\$ 1,049,917	\$1,091,208
Net Income from Educational & General	\$ 72,574	\$ 65,583	\$ 102,624	\$ 66,128	\$ 72,530	\$ 95,722
Auxiliary Enterprise Revenues	\$ 138,771	\$ 146,216	\$ 158,547	\$ 165,005	\$ 145,845	\$ 152,124
Auxiliary Enterprise Expenditures	\$ 116,386	\$ 122,269	\$ 133,096	\$ 144,467	\$ 140,500	\$ 143,623
Net Income from Auxiliaries	\$ 22,385	\$ 23,947	\$ 25,451	\$ 20,538	\$ 5,345	\$ 8,501
Net Income from Operations	\$ 94,959	\$ 89,530	\$ 128,075	\$ 86,666	\$ 77,875	\$ 104,223
Cash flow	\$ 153,008	\$ 149,735	\$ 191,636	\$ 152,115	\$ 143,324	\$ 177,389

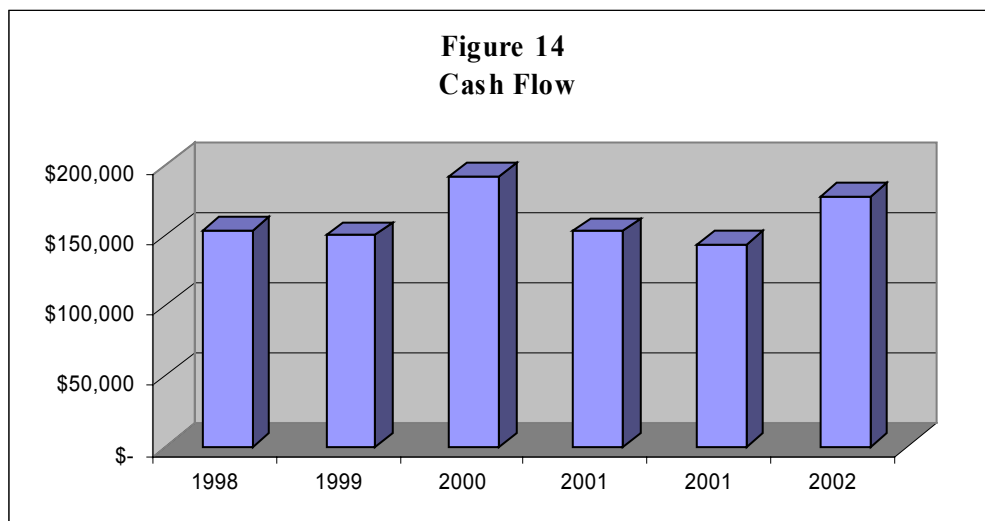
Auxiliaries include housing, the bookstore, intercollegiate athletics and some other operations that are not directly related to the educational mission of the institution. The changes brought about by GASB 35 significantly decreased the net income from Auxiliaries primarily because of changes in reported revenue. Figure 12 shows the changes in net income from auxiliaries.



The overall effect of the changes brought about by GASB 35 was to reduce net income in 2001 by \$8.8 million. Thus it is quite remarkable that in 2002 the University earned \$104.2 million which was only surpassed in 2000 when the University earned \$128.1 million. Figure 13 shows the changes in net income described in Table 9.

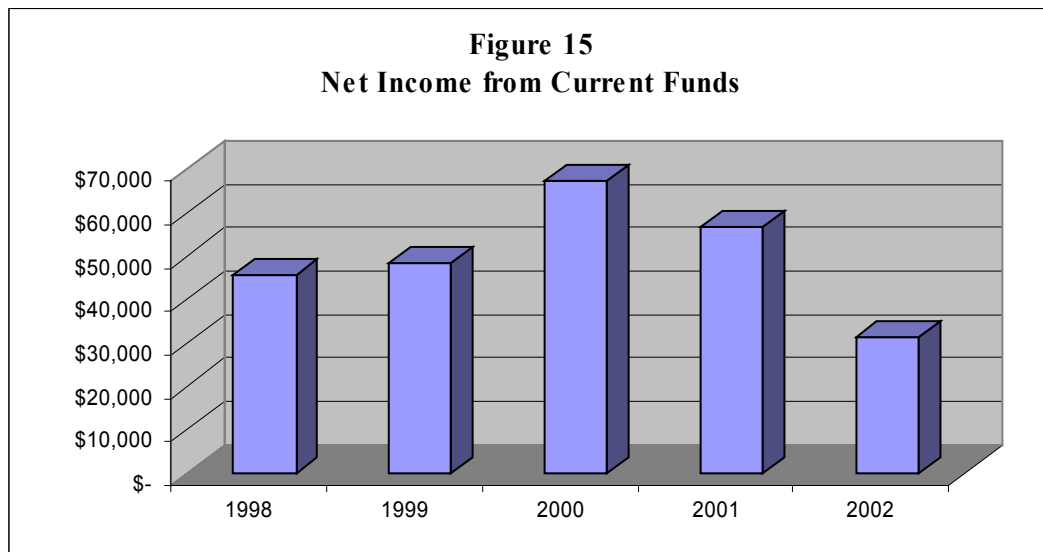


Finally, Table 9 also shows the cash flow of the University which is defined as net income plus depreciation. Depreciation is an expense and therefore it reduces net income. It is important for faculty to realize that depreciation is a non-cash expense. Most expenses result in an outflow of resources from the University. However, in the case of depreciation the University shows this as an expense reflecting the wear and tear on buildings and equipment but this expense does not result in an outflow of resources from the University. In theory depreciation represents wear and tear on plant and equipment and allows firms to set aside funds to renew and replace equipment and buildings when they are worn out. In the case of universities, including Rutgers they receive a significant portion of capital funding in the form of a separate appropriation from the state. In addition universities also conduct capital campaigns to raise money from donors to finance renovations and new construction. In this respect they differ markedly from private businesses that must raise money either through borrowing or the sale of stock. Thus in reality depreciation although it is technically an expense is in reality a vehicle for raising cash. Figure 14 shows the cash flow for Rutgers. Clearly over the five year period Rutgers has had a fairly stable and significant cash flow.



One of the issues brought up frequently by administrations is that a great deal of the money that flows into universities is designated for capital projects and therefore cannot be spent for operations. In fact this issue was discussed earlier in this report. To get some sense of how much money is actually available for operations we look at the net income earned in the current fund. Net income from the current fund is defined as current fund revenues minus current fund expenses and mandatory transfers. Mandatory transfers are payments that the University is obligated to make such as interest payments on debt. Beginning in 2002 it is not possible to calculate net income from current funds because of the changes in reporting brought about by GASB 35. The number used for 2002 is an estimate based on taking the revenue and expense categories from the Statement of Revenues, Expenses and Changes in Net Assets that would correspond with current fund revenues and expenses and using interest paid on debt and principal payments in lieu of mandatory transfers. Finally we estimate a comparable number for

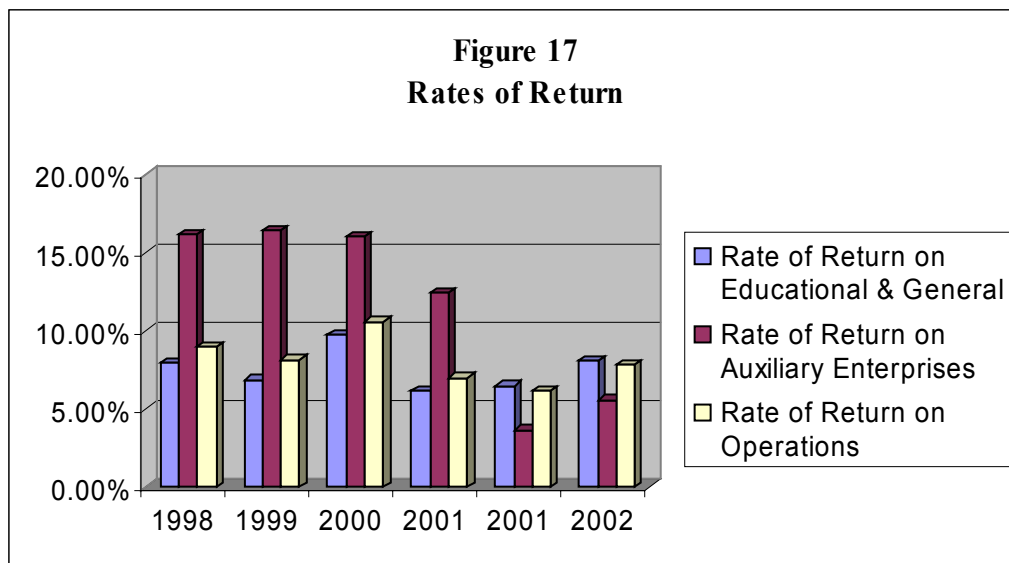
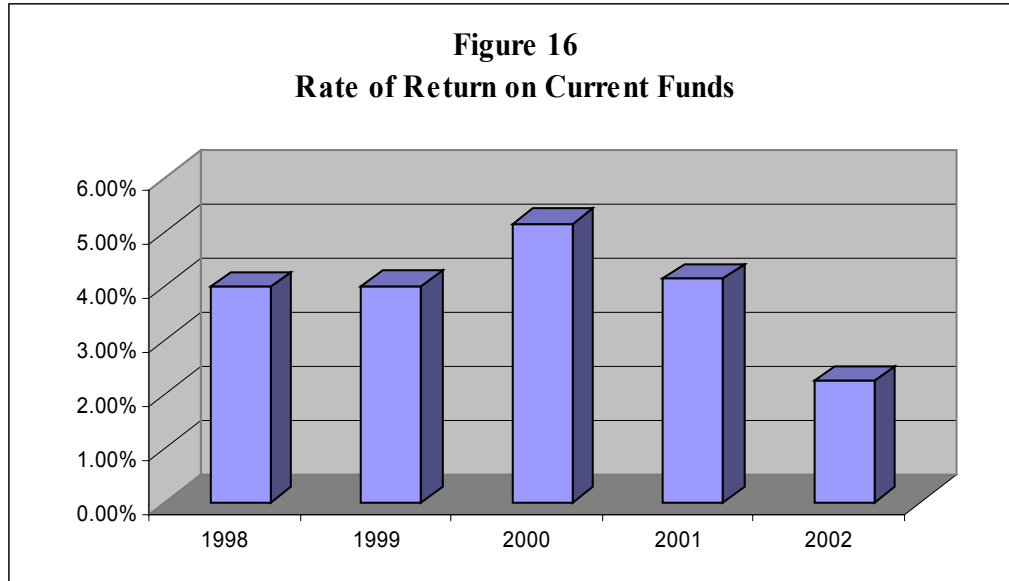
student aid in 2002 by assuming that student aid was 66 percent of tuition and fees which is based on the ratio of student aid to tuition and fees in 2001. Figure 15 shows the net income from the current fund. Clearly net income from the current fund is substantially less than the overall net income for the University although Rutgers has a significant level of net income from current funds. Over the five year period from 1998-2002 Rutgers had an average net income from current funds of \$49.8 million. In general net income from current funds follows the same trends as the overall net income although the two diverge in 2002. This means that although Rutgers had relatively high net earnings in 2002 a larger than normal share of that net earnings came in the form of funds dedicated to non-operating activities such as capital construction. Nevertheless we still estimate that Rutgers earned \$31.3 million in current income in the year 2002.



Total Operations Ratios

Figure 16 shows the net income ratio for current funds for the University from 1998 to 2002. Net income for current funds is calculated by taking current revenues and additions and subtracting expenditures and mandatory transfers and then dividing by current revenues and additions.

Figure 17 shows three other income ratios. First is the ratio of net income from educational and general activity which is calculated by taking net income from educational and general activity and dividing by revenue from educational and general activity. The second ratio shows the rate of return on auxiliary operations and is found by taking net income from auxiliaries and dividing by revenue from auxiliaries. The final ratio in Figure 17 is the overall rate of return on operations.



Again the rates of return mirror the actual levels of net income in their patterns. The only noteworthy change in the rates of return is the significant decline in the rate of return to auxiliary operations. This change appears to be largely a function of GASB 35 as opposed to any dramatic changes the actual revenues or expenses associated with auxiliary operations.

Cash Flows

Another picture of the flows of revenue into and out of the University can be seen by looking at the Statement of Cash Flows for the University. Unfortunately this Statement is a result of the change in reporting format brought about by GASB 35 and

thus the Statement only exists for 2001 and 2002 as reported in the 2002 financial statements.

The Statement of Cash Flows has four major components. 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. Second are cash flows from non-capital financing activities the largest of which 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.

In 2001 the Statement of Cash Flows shows a net increase in cash and cash equivalents of \$4.2 million and in 2002 there was a net increase of \$33.1 million. On the surface these numbers seem substantially small than the net income of the University particularly in 2001. However, if one takes cash flows from operations, non-capital financing, investing activities and payments of principal and interest then the University would have had a net increase in cash of \$143.1 million in 2001 and \$68.9 million in 2002. In other words, the smaller increases reported in the University's cash flow statement are primarily the result of construction activity and the purchase of capital assets.

In conclusion, Rutgers has had a substantial and fairly stable net income averaging \$101 million per year. A portion of this income is committed to capital projects but the University has operating revenues that are substantially greater than its operating costs resulting in a positive net income.

Sources of Revenue:

The Income ratios in Figures 18 and 19 show the major sources of revenue for the University for FY 1998 and 2002. The largest single source of revenue for Rutgers University is state appropriations followed by grants and contracts. Tuition net of student aid accounts for a relatively small portion of Rutgers revenue. What Figures 18 and 19 also reveal are some alarming trends in sources of revenue. The state share of revenue has declined from 41 percent in 1998 to 37 percent in 2002. At the same time tuition net of student aid has increased from 6 percent to 10 percent of revenue. Revenue from grants contracts and gifts has also increased slightly as a percentage of revenue and not surprisingly revenue from endowment and investments has declined as a source of revenue.

Figure 18
Sources of Revenue in 1998

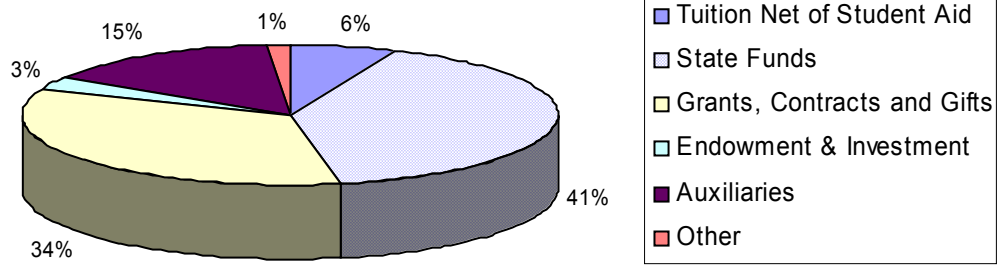
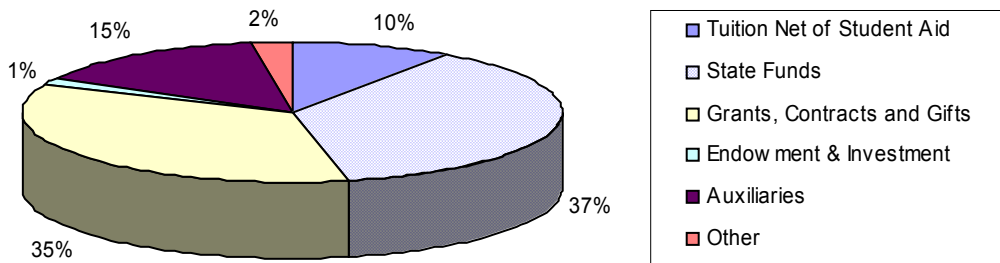
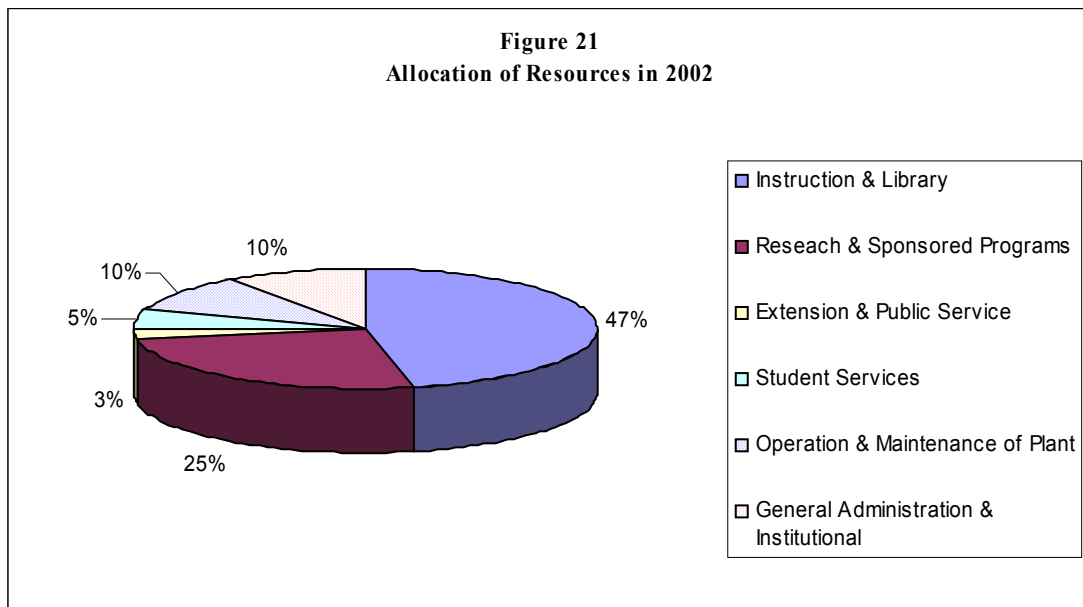
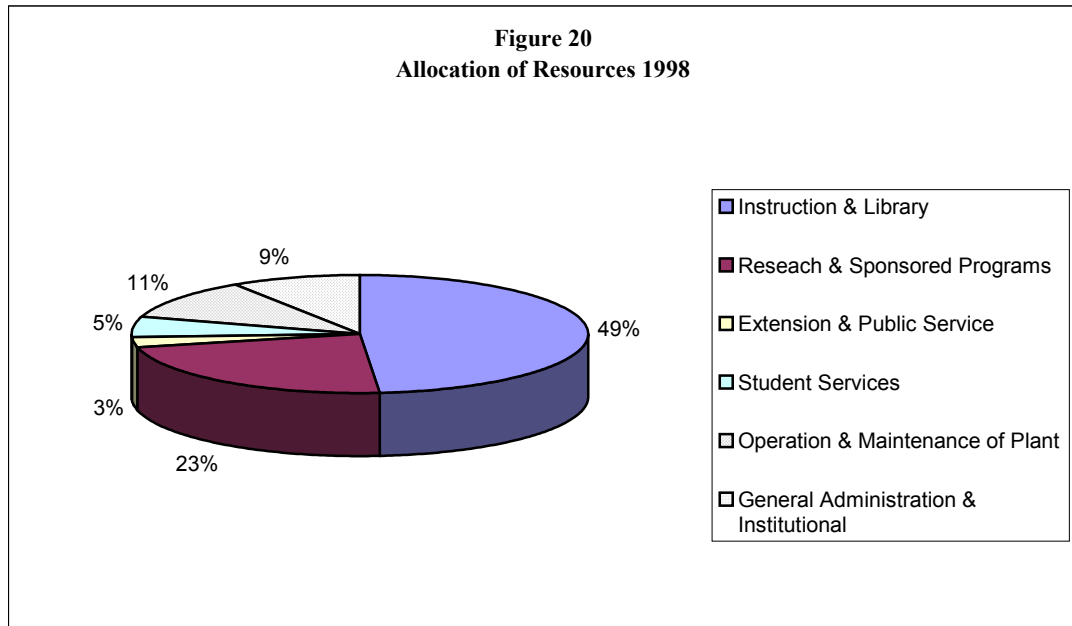


Figure 19
Sources of Funds 2002



Allocation of Expenses

Figures 20 and 21 show how expenses are allocated at Rutgers for both 1998 and 2002. The largest single expense is spending on instruction and library followed by spending on research and sponsored programs. It is worth noting that in 1998 spending on instruction and libraries declined from 49 percent of the total to 47 percent of the total and spending on administration increased from 9 to 10 percent.



Conclusion

This report shows that the financial condition of Rutgers University has improved over the period from 1998-2002. The University's financial condition can be summarized by looking at three key ratios. These ratios are often used by bond rating agencies to assess the credit worthiness of an institution. The Ohio Board of Regents has developed a methodology to assign scores these three and then use a weighted average of those scores to create a composite index indicating the financial health of an institution (<http://www.regents.state.oh.us/financial/sb6.html#Methodology>).

The first is the ratio is known as the viability ratio, which is the ratio of expendable balances to long-term debt. The second ratio is the primary reserve ratio, which measures the ratio of expendable balances to expenses. (Alternatively before GASB 35 the primary reserve ratio was calculated as the ratio of expendable balances to current fund expenditures and mandatory transfers.) Before the implementation of GASB 35 the final indicator was the net income ratio, which was defined as current fund revenues and additions, minus current fund expenditures and mandatory transfers, divided by current fund revenues and additions. The methodology for calculating composite scores has changed because net income can no longer be calculated from data in the financial statements. Under the new methodology the change in net assets divided by total revenues (operating and non-operating) is substituted for the net income ratio.

Scores for each of the three ratios are whole numbers from 0 to 5 with 5 being the highest score. A weighted average of these scores is 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 10
Composite Scores
for year ending June 30**

	1998	1999	2000	2001	2002
Viability Score	3	3	4	4	4
Primary Reserve Score	4	4	4	4	4
Net Income Score	5	5	5	5	5
Composite Score	3.9	3.9	4.2	4.2	4.2

Table 10 shows the individual scores for each ratio and composite scores for Rutgers University from 1998 to 2002. The scores for most of the indicators have been fairly stable. The viability score has actually improved moving from 3 to 4 between 1999 and 2000 reflecting the upward trend in the viability ratio. Although there have been changes in both the primary reserve ratio and the net income ratio these changes have not been substantial and thus the primary reserve score and the net income score have remained stable.

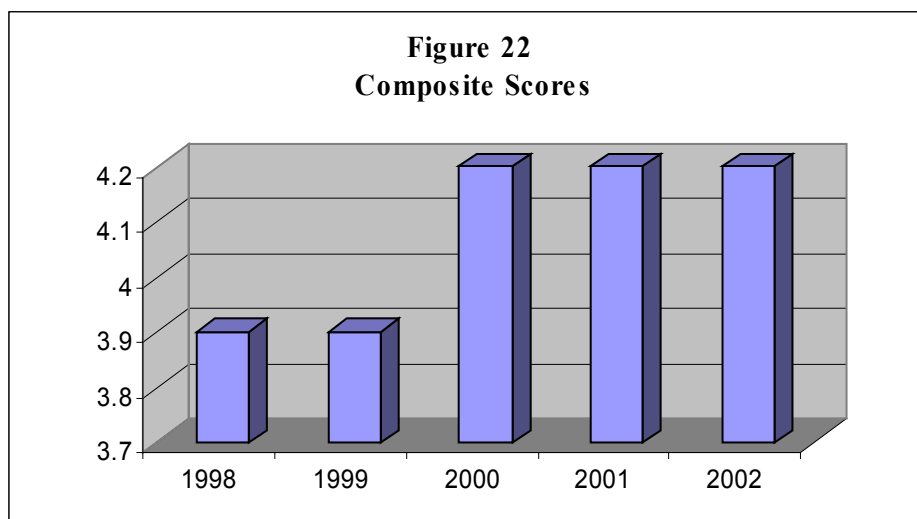


Figure 22 provides a graphical view of the composite scores for the period 1998-2002. The composite score was stable from 1998 to 1999 and then increased in 2000. Since 2000 the composite score has remained constant. It is also important to note that the scale for composite scores runs from 0 to 5 and so even the scores for 1998 and 1999 were fairly high. Most of the indicators of the University's financial health indicate that the University has improved its performance over the last five years.

This conclusion is reinforced in Management's Discussion and Analysis in the 2002 financial statement. Management points out that in 2001 that Moody's upgraded the University's bond rating from A1 to Aa3 and also noted that Standard and Poor's maintained its positive outlook for the University during a recent review of a new debt offering by the University. Management also notes that it is projecting increased enrollment with enrollment in 2002 surpassing the record enrollment of the previous year. The bottom line is that Rutgers University is in very good financial condition and is therefore in a position to invest in improving faculty compensation.