



UNIVERSITY OF GUAM

FY10 AUDIT MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The objective of management's discussion and analysis (MD&A) is to provide readers of the University of Guam's (University or UOG) financial statements an overview and better understanding of its financial position and results of activities for the fiscal year ended September 30, 2010. Management has prepared this overview as required supplemental information to the financial statements and the footnotes that follow. This MD&A should be read in conjunction with the financial statements and accompanying footnotes.

The University. Public Law 13-194, The Higher Education Act of 1976, established the University as a non-membership, non-profit, public corporation under a Board of Regents appointed by the Governor with the advice and consent of the Guam Legislature. The University is a public, open-admissions, four-year land grant institution on the island of Guam in the Marianas Islands. It has been continuously accredited by the Western Association of Schools and Colleges (WASC). The 3,639 students (Fall'10 headcount) are multicultural, multilingual and 92% Asian-Pacific Islander. There are 15 master's degree programs, 34 undergraduate programs, and one (1) associate degree program in nursing. In addition, continuing education, professional development and English language training are offered. There are 198 full-time and 88 part-time faculty, 29 administrators and 579 full- and part-time staff.

The Leadership. The University is governed by a nine-member Board of Regents. Peter "Sonny" Ada is the Chair. W. Chris Perez is Vice Chair. Cynthia Henson is Treasurer and audit committee chair. Robert A. Underwood, Ed.D., is the University's tenth President, Helen J.D. Whippy, Ph.D., is Senior Vice President of Academic and Student Affairs. David M. O'Brien is Vice President of Administration and Finance. Zeny Asuncion-Nace is Comptroller.

In the ninth year of its strategic plan the University is focused on its mission of Ina, Deskubre, Setbe (to Enlighten, to Discover, to Serve) and on its core commitments: i) academic quality; ii) student success, enrollment growth, retention, and institutional visibility; iii) community engagement; and iv) institutional effectiveness and efficiency. As the island undergoes its most dramatic transformation since World War II due to the U.S. military buildup and Guam's growth, the University has identified three overarching themes: UOG Green, the Natural Choice and Leading Change (Center for Island Sustainability).

THE FINANCIAL STATEMENTS

The report includes three financial statements for FY2010: i) the Statement of Net Assets; ii) the Statement of Revenues, Expenses and Changes in Net Assets; and iii) the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for colleges and universities.

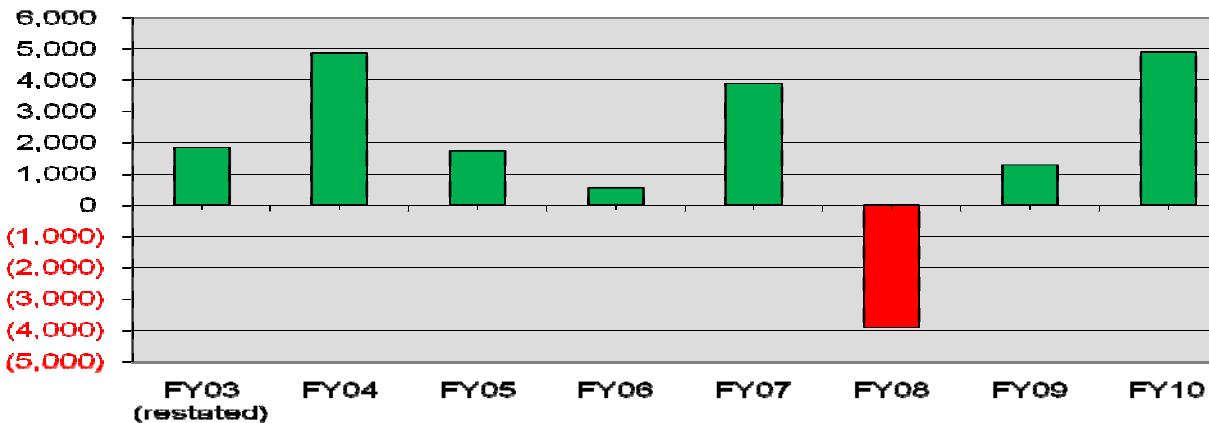
The University is reported as a component unit of the government of Guam. The University also reports the financial statements of a component unit, the UOG Endowment Foundation. The Foundation is a legally separate, tax-exempt, private corporation. While the University does not control the Foundation, the resources and income of the Foundation can only be used by or for the benefit of the University.

FY2010 FINANCIAL HIGHLIGHTS AND STRATEGIC INSTITUTIONAL OUTCOMES

One of the most important questions in evaluating the financial health of an institution is whether it is financially better off at the beginning of the year or at the end of the year. In FY2010 the University's finances showed a \$4.9 million increase in net assets, which is a 6% surplus on total revenues. This is a \$3.6 million improvement over the prior year; due mainly to substantial operating revenue growth that adequately covered expense increase, ongoing

financial and cash management controls in the face of government shortfalls in appropriation payments throughout the fiscal year, and unrealized gains in investments.

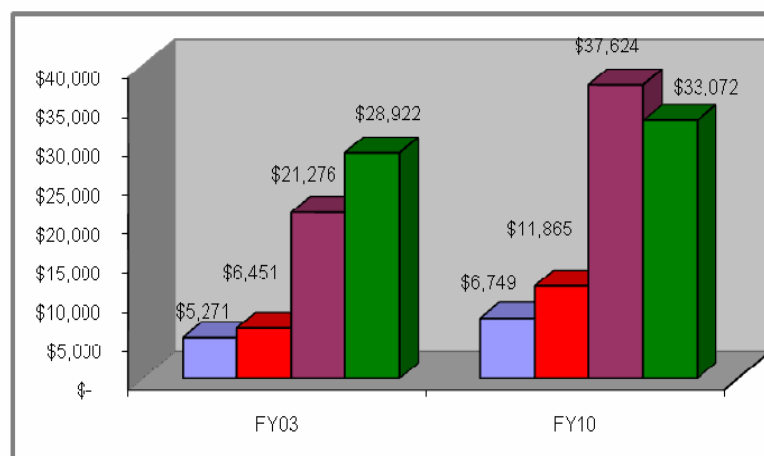
CHANGE IN NET ASSETS FY03-10 (IN \$000'S)



Important financial trends include:

- There has been a financial surplus in seven of the last eight years.
- Consolidated revenues have continued to grow and diversify.
- Revenue growth more than adequately covered additional expenditures for increased enrollment, new grants, facility upgrades, merit-based salary increases, and retirement fund contribution rate increases.
- The University has achieved low risk auditee status for the sixth consecutive year.

REVENUE GROWTH (IN \$000'S)



Seven-year Growth FY03-10
14% GovGuam Appropriation
77% Grants and Contracts
84% Tuition and Fees
28% Other Revenues

Significant institutional outcomes include:

- Student enrollment of 3,639 in Fall '10 is the highest since Fall '00.
- 458 graduates in AY 2009 are the highest since 2001.
- The University remains committed to academic quality, evidenced by primary accreditation for eight (8) years from the Western Association of Schools and Colleges (WASC) and by secondary accreditation for the professional schools. In 2010 Nursing received accreditation for eight (8) years, the maximum.

- Federal grants and contracts grew \$6.8 million (24%) over the prior year.

STATEMENT OF NET ASSETS

The statement of net assets is similar to a balance sheet. It presents information on assets, liabilities and the resources remaining after liabilities are satisfied. The statement is an indicator of overall financial condition, and whether financial health has improved or deteriorated during the fiscal year.

SUMMARY STATEMENTS OF NET ASSETS (IN \$000'S)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Non-capital Assets	48,351	\$ 41,211	\$ 35,401
Capital Assets	<u>68,793</u>	<u>70,192</u>	<u>72,048</u>
Total assets	<u>\$ 117,145</u>	<u>\$ 111,403</u>	<u>\$ 107,449</u>
Current liabilities	\$ 13,091	\$ 12,332	\$ 9,856
Non-current liabilities	<u>15,129</u>	<u>15,052</u>	<u>14,898</u>
Total Liabilities	<u>\$ 28,220</u>	<u>\$ 27,384</u>	<u>\$ 24,754</u>
Invested in capital assets, net of related debt	\$ 56,006	\$ 57,262	\$ 58,929
Restricted	6,386	6,303	10,980
Unrestricted	<u>26,533</u>	<u>20,454</u>	<u>12,786</u>
Total Net assets	<u>88,925</u>	<u>\$ 84,019</u>	<u>\$ 82,695</u>
Total liabilities and net assets	<u>\$ 117,145</u>	<u>\$ 111,403</u>	<u>\$ 107,449</u>

The University's overall financial condition strengthened during FY2010 due to net revenue growth, adherence to a cash-based financial management plan and successful management of the investment portfolio. Total net assets, the residual interest in assets net of liabilities, increased by \$4.9 million.

Assets. Current assets consist primarily of cash and cash equivalents (18%), government appropriations (13%), tuition receivables for tuition (14%), federal grants and contracts (19%), and others (36%). Current assets cover current liabilities 2.2 times, a positive indicator of liquidity. Noncurrent assets include restricted cash (5%), investments (17%), and capital assets (78%). Higher cash and investment balances resulted from the rebound in equity markets and higher investment portfolio valuations in an up market, lower receivables of tuition and government appropriations, and implementation of the Board's reserve policy. Grant and contract receivables grew, reflecting the growth.

Liabilities. These are accounts payable, deferred tuition revenue, accrued employee annual and sick leave, deposits for others and long-term debt. The increase of \$0.8 million includes additional accrued leave liability during the fiscal year and additional reserves for liability claims.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The statement of revenues, expenses and changes in net assets provides details of operating and non-operating revenues and expenditures, similar to an income statement.

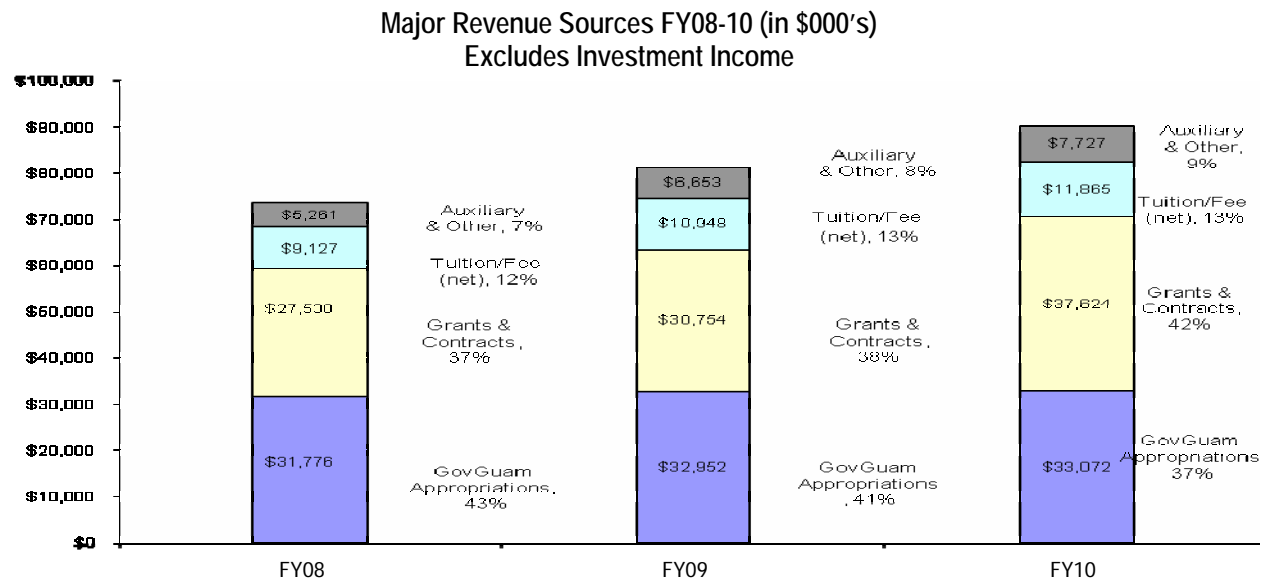
SUMMARY STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (IN \$000'S)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Operating revenues	\$ 57,216	\$ 48,355	\$ 41,926
Operating expenses	<u>84,349</u>	<u>77,395</u>	<u>72,411</u>
Operating revenues net of operating expenses	(27,133) ¹	(29,040)	(30,485)

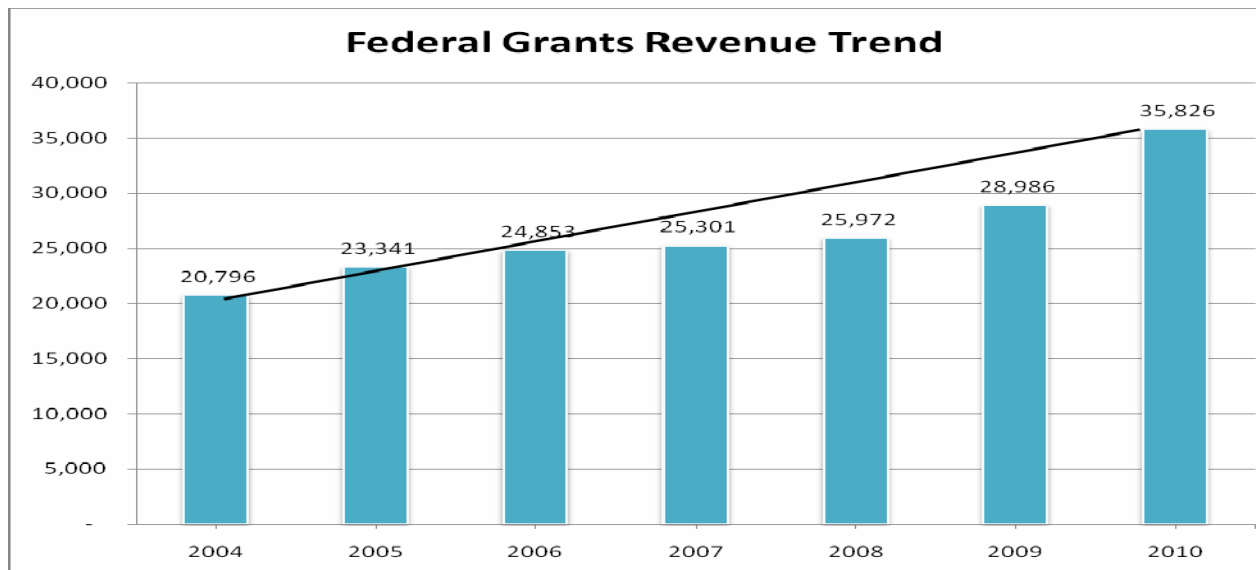
¹The total of operating revenues net of operating expense is negative because local government appropriations are reported as non-operating revenues rather than operating revenues under GASB 35 reporting requirements

Non-operating revenues	<u>32,039</u>	<u>30,363</u>	<u>26,577</u>
Increase (Decrease) in net assets	4,906	1,323	(3,908)
Net assets – beginning of year	<u>84,019</u>	<u>82,696</u>	<u>86,604</u>
Net assets – end of year	\$ <u>88,925</u>	\$ <u>84,019</u>	\$ <u>82,696</u>

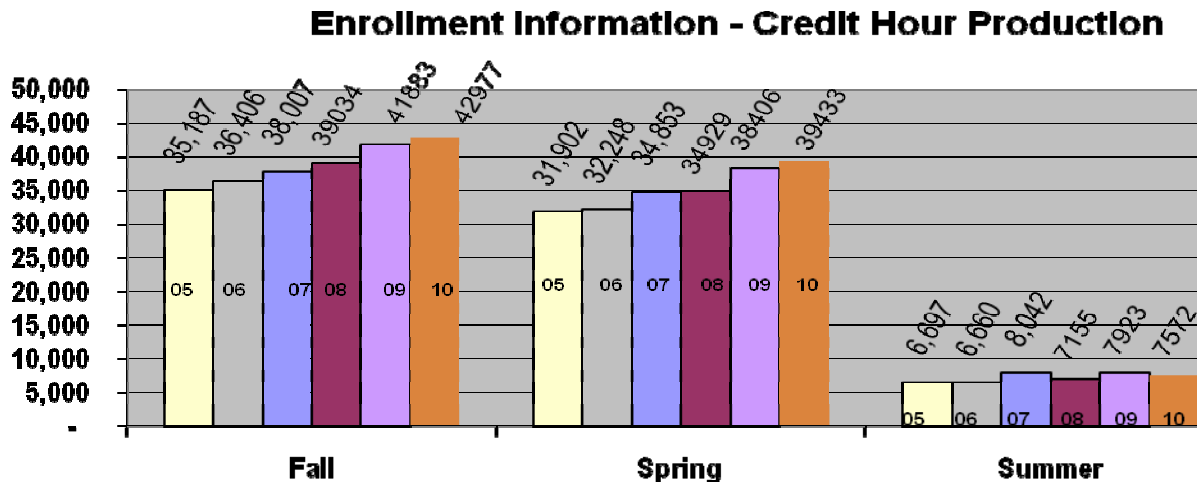
Revenues. The University brought in over \$57.2 million from operations (excluding government appropriations and investments), an unprecedented increase of \$8.9 million (18%). The growth and diversification of revenues can be seen in the graph below: i) In FY08 appropriations were 43% of consolidated net revenues (net of investments) and University-generated sources represented 53%, while by FY10 appropriations decreased to 37% of the total and University-generated sources increased to 63%; and ii) For every \$1 appropriated, the University generates \$1.73.



Federal grants and contracts led revenue growth with an increase of \$6.9 million (24%), including multi-year grants. For FY10, the University has the following multi-year grants: cancer research (\$1.6 million); regional health education (\$1.2 million); master's program for the blind/ visually impaired (\$0.3 million); and alternative energy and green projects. Pell Grants and student loans increased.

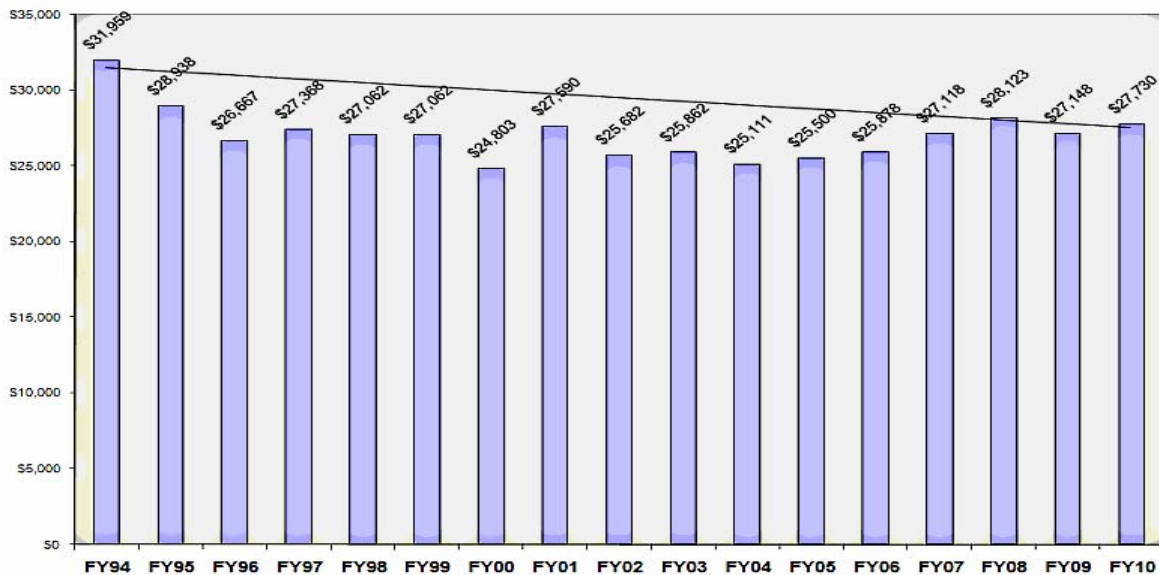


Gross tuition and fees contributed \$2.2 million (12%) to revenue growth. The growth came from increases in student enrollment, as tuition and fee rates remained unchanged.



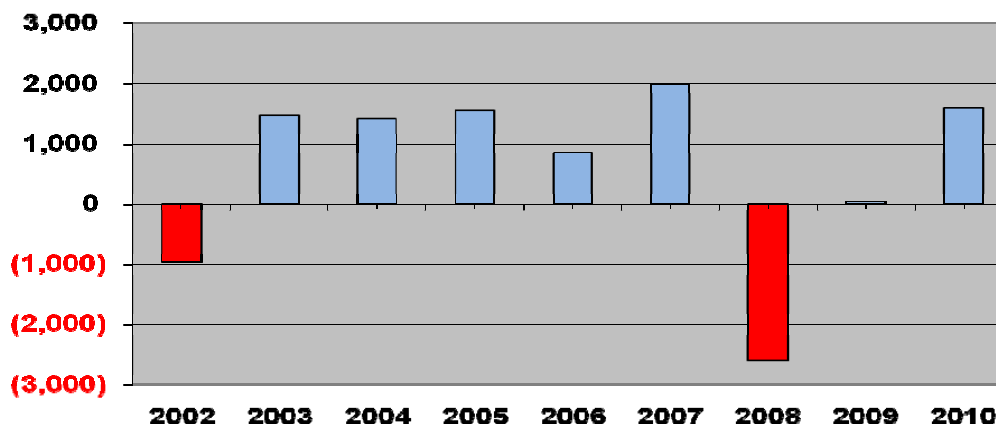
Overall, government of Guam appropriations remained steady. Still, appropriations for operations increased \$1.1 million (4%), as the legislature provided additional funds for growth initiatives and nursing faculty. This increase was net of the 3% allotment holdback imposed, which reduced appropriation payments by \$1 million.

GENERAL OPERATIONS APPROPRIATION FROM GOVERNMENT OF GUAM (IN \$000'S)

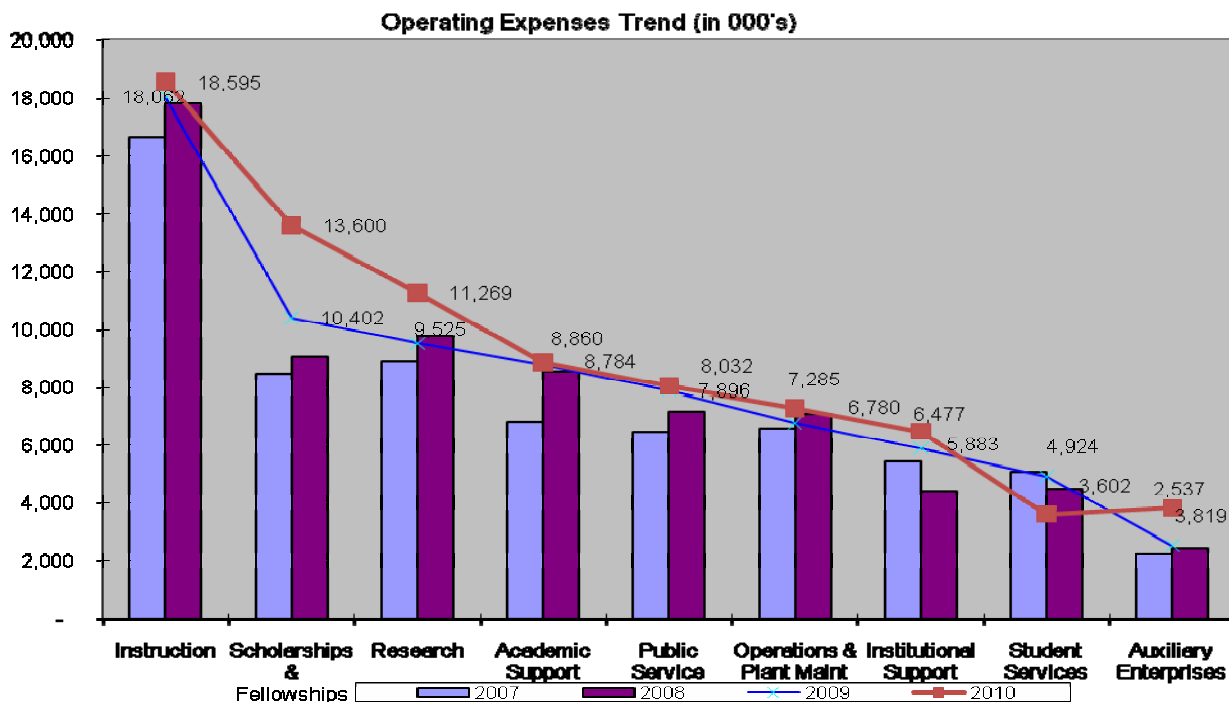


After several years of correction and turbulence in the global equity markets, the markets rallied during the second half of the fiscal year. Investment income was \$1.6 million (primarily unrealized gains).

Net Investment Income (Loss)
(in \$Thou)



Expenses. FY2010 total operating expenses were \$84.3 million, an increase of \$7 million (8%) which is not surprising given the increase in federal grants and in enrollment. Revenue growth more than adequately covered additional expenditures for increased enrollment, new grants and contracts, campus facility upgrades, employee merit increases, and retirement contribution increases. The University spent \$37.9 million directly on its core mission. Of that, 49% went to instruction, 30% to research, and 21% to public service. In addition, the University spent \$18.9 million on libraries, technology and student, academic and administrative support; \$13.6 million on student aid (net of \$8.9 million of scholarship discounts and allowances); \$7.2 million on campus maintenance; \$2.8 million in depreciation; \$3.8 million on auxiliaries; and \$2 million in debt service payments for various academic buildings. Total encumbrances (recorded obligations) were \$6 million, an increase of \$3.1million, primarily due to increasing grant activities.



STATEMENT OF CASH FLOWS

This statement provides information about the ability to generate the cash flows needed to meet financial obligations and the extent to which external financing is being used to fund operations.

STATEMENTS OF CASH FLOW (IN \$000'S)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash provided by (used in):			
Operating activities	\$ (26,197)	\$ (24,497)	\$ (28,373)
Non-capital financing activities	33,666	33,129	36,378
Capital and financing activities	(3,397)	(4,503)	(5,684)
Investing activities	<u>(2,885)</u>	<u>(5,037)</u>	<u>189</u>
Net change in cash and cash equivalents	1,187	(908)	2,510
Cash and equivalents – beginning of year	<u>4,159</u>	<u>5,067</u>	<u>2,557</u>
Cash and equivalents – end of year	<u>\$ 5,346</u>	<u>\$ 4,159</u>	<u>\$ 5,067</u>

The University's cash position increased by \$1.2 million. Typically, the University's cash position at fiscal year end is higher than its normal cash position during the balance of the year. This is because Fall semester tuition payments are booked at the end of the fiscal year, and the government makes catch-up allotment payments close to fiscal year-end. Tuition revenues are subsequently allocated for academic expenses during the remainder of the academic year, which overlaps the fiscal year. Financial planning requires that there be an adequate amount of cash on hand at the start of the new fiscal year to pay for prior year encumbrances, insurance premiums, continuing infrastructure restoration and operating needs. University policy requires cash reserves for sustainability and capital investment. A reserve fund and sub-accounts were established and funded in FY2009 and FY2010. As in prior years, cash flows were negatively influenced by the government deficit, which led to delays and shortfalls in allotment payments.

CAPITAL ASSETS AND LONG-TERM DEBT

Capital Assets. At the end of fiscal year 2010, the University had invested 108M in capital assets and had accrued \$40M in accumulated depreciation against the assets. This represents a decrease (including additions and deletions) of \$1.4M or 2.6% from the previous year. See Note 8.

Long-Term Debt. The University has a note payable that is outstanding with the United States Department of Agriculture (USDA). The note payable was created in October 2001 through Public Law 26-48 for an amount not to exceed \$13.5M for the purposes of constructing certain facilities on campus. As of September 30, 2010, the University had a long-term debt of \$12.8M. See Note 6.

ECONOMIC AND OTHER FACTORS EXPECTED TO AFFECT THE FUTURE ²

After the deepest recession since the 1930's Great Depression, the U.S and global economies have begun to slowly recover from 2008's financial crisis. It has been, and will likely continue to be, an uneven and bumpy road. Negative factors include stubborn unemployment, a weak housing market and burgeoning debt obligations in the U.S. and several European countries. Positive factors include renewed business and investor confidence, strong demand for exports from developing economies and the U.S. dollar as a safe haven. In the financial markets U.S. Treasury yields have fallen, while investment-grade and corporate bond markets enjoyed excess returns. U.S. and global equity markets rebounded with double-digit returns.

In 2010 the government of Guam operated under another year of stagnant revenues and lowered expectations. The takeoff in economic growth associated with the military buildup did not materialize. After delays and political controversy, there was some progress on the military buildup with the announced Record of Decision to proceed with the plans to relocate military forces to Guam from Okinawa. There were several other economic bright spots: air service to Guam expanded; visitor arrivals rebounded by 11%; employment increased by 2,000 jobs; and business activity increased. However, economic growth fell far short of what was anticipated. Reported General Fund revenues were below projections. Unaudited financial statements show that the General Fund deficit is expected to increase by \$89 million to \$354 million cumulative.

2011 has ushered in financial belt tightening. Governor Edward J.B. Calvo assumed office in January. He has inherited a stagnant economy, delays in the military buildup and a barren cash drawer. The FY2011 budget law projected General Fund revenues to increase substantially, particularly as construction associated with the military buildup and ARRA projects increases over the latter half of the year. Allotment controls may be administered, as government expenditures are outpacing cash collections and large obligations are unbudgeted or under budgeted. The Governor has publicly called for cost austerity and has rescinded recent government staff salary adjustments to preserve cash. This will impact the University's appropriations and allotment payments, a situation that is familiar ground for the University and a challenge to which it has risen in the past.

Nevertheless, 2011 is expected to be Guam's long-awaited transition to several years of unprecedented economic growth and social change, as the military buildup gains steam. By mid-year increases in U.S. Department of Defense construction projects, even with phasing of the military investment due to financial and social constraints, and the fulfillment of the \$240 million of American Recovery and Reinvestment Act (ARRA) projects, which were awarded last year but are just now getting underway, will bring employment, investments and substantial cash infusions. The University has \$17 million of ARRA projects either underway or bid. The federally funded projects are an extraordinary infrastructure investment in technology and building renovations.

The University is seeking new capacity to lead change and train the professionals who will deliver economic growth. The University sees itself as more than just the institution of higher education for Guam and the Micronesian region. It is an economic driver and the region's primary instrument of creating a professional class, which will become the

²With thanks to Gary Hiles, Chief Economist, Guam Department of Labor, and Dr. Clare Ruane, Professor of Economics and Finance, University of Guam, for their input and comments.

middle class for island societies into the foreseeable future. To those ends, the University has identified strategic challenges: i) Increased enrollment of high school graduates who enter the University prepared to pursue college degrees: ii) Institution-wide implementation of distance education courses and programs and new technological capacity: iii) Strengthening of professional programs and the creation of a School of Engineering: iv) Additional infrastructure capacity in a Student Services Center and Engineering Annex: and v) A fully functional Center for Island Sustainability within the University with a regional advisory council to coordinate with regional states and institutions for the purposes of conducting research, developing policy and leading public discussion on critical environmental, economic and social issues.

In summary, this is a familiar story re-told – rekindled optimism and opportunity tempered by the reality of the government's financial and cash position. Nevertheless, the opportunities are real, even if they are delayed by a year or two. The University will be responsible to the challenges our island societies face to develop a sustainable economy that protects our environment and enhances the quality of our lives.

For further news and up-to-date information concerning the University of Guam, please visit the website at www.uog.edu for the University's annual report, interim financial statements, WASC reports and other publications.