UNIVERSITY OF ALBERTA

Financial Statement Discussion and Analysis

For the Year Ended
March 31, 2014

The financial statement discussion and analysis should be read in conjunction with the University of Alberta annual audited financial statements. The discussion and analysis and the audited financial statements are reviewed and approved by the University of Alberta Board of Governors on the recommendation of the University of Alberta Audit Committee. The university's financial statements have been prepared in accordance with Canadian Public Sector Accounting Standards.

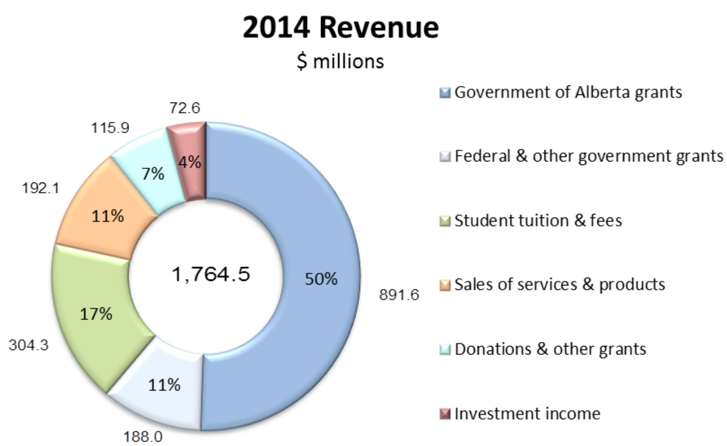
For more in-depth discussion and analysis of the university's goals and objectives please refer to the following documents: 2013-14 Annual Report, 2014 Comprehensive Institutional Plan, Dare to Discover: A Vision for a Great University, Investment Reports.
Website link, click on Key Strategic Planning Documents or Investment Reports:
http://www.financial.ualberta.ca

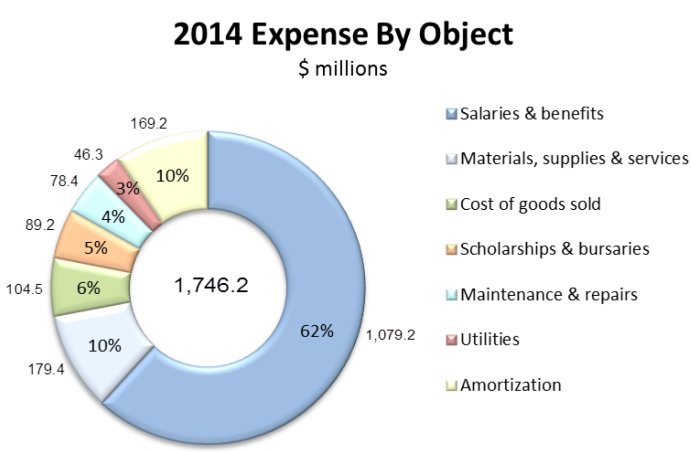
The discussion and analysis provides an overview of the university's:

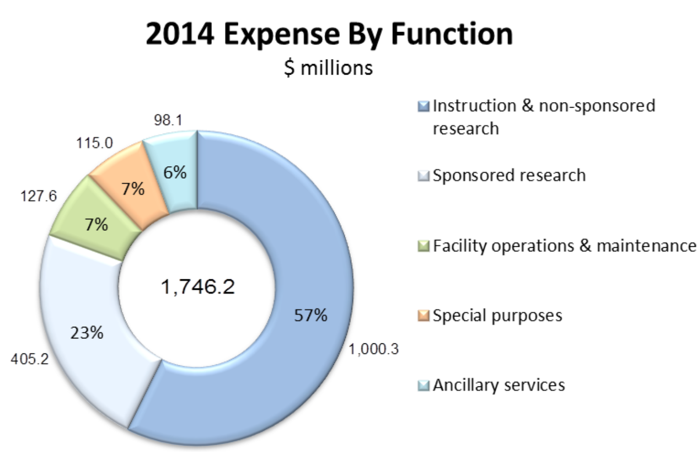
- Financial Results
- Net Assets
- Capital Planning
- Areas of Significant Financial Risk

Financial Results

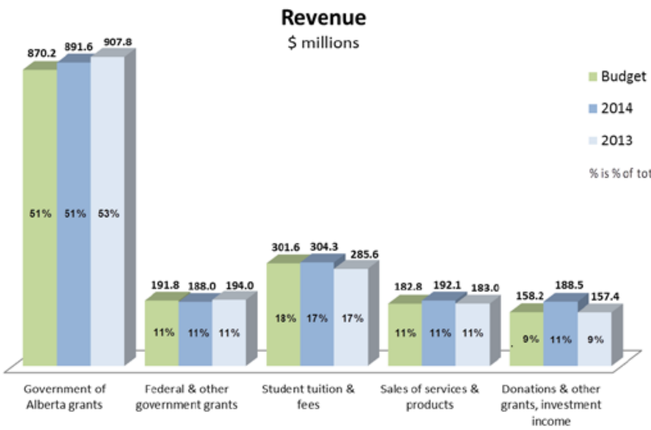
From total revenue of $1,764.5 million, the university ended the year with an excess of revenue over expense of $18.4 million. Net assets increased by $156.3 million with increases in endowments ($113.8), investment in tangible capital assets ($31.4) and unrealized investment gains ($24.1). The increase in investment in tangible capital assets was funded by the excess of revenue over expense and an increase to the accumulated deficit from operations of $13.0 million.







Revenue



Total revenue amounted to $1,764.5 million and has increased by $36.7 million over the prior year.

Government of Alberta (GoA) Grants

Grants from GoA represent the university's single largest source of funding for university activities. GoA grants decreased as compared to prior year due to the decrease in the Campus Alberta operating grant ($24.2). GoA grants are $21.4 million more than budget mainly due to the Campus Alberta grant adjustment ($14.4) that was announced mid-year and a one-time tuition fee regulation grant ($3.9).

Federal and other government grants

Federal and other government grants primarily support the university's research activities. There are no significant differences compared to prior year or to budget.

Student tuition and fees

Enrollment is comparable to last year and will remain relatively stable over the next few years. The annual budgeted increase is due to the increase in instructional fees, which is based upon the increase to the annual CPI.

Sales of services and products

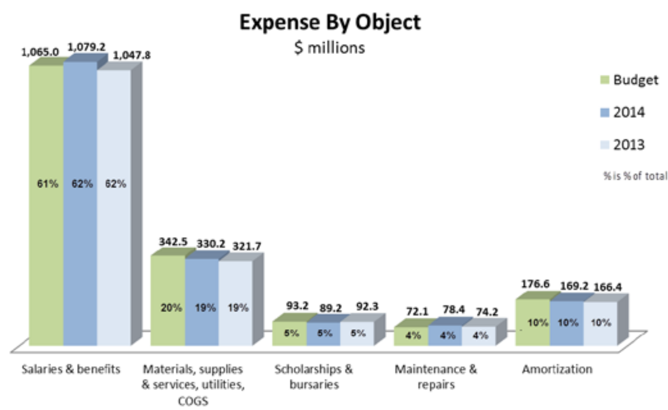
Ancillary services and academic and administrative units generate revenue thorough the sale of services and products to individuals and organizations external to the university. Ancillary services generated sales of $96.6 million and academic and administrative units generated sales of $95.5 million. Sales revenue is $9.2 million more than budget due to a general increase across many academic and administrative units.

Donations and other grants, investment income

Donations and other grants support many university activities; a significant portion of this funding is in support of research activities. There were no significant differences compared to prior year or to budget.

Investment income increased by $31.6 million compared to prior year and is $33.3 million more than budget. Investments primarily fall into two categories, the Unitized Endowment Pool (UEP) and the Non-Endowed Investment Pool (NEIP). The UEP returned 15.4% (2013: 12.2%) and represents the majority of the university's long-term investment strategy. In fiscal 2013-14 several investment managers in the long-term strategy were replaced. This necessitated the sale of investments that had appreciated in value and resulted in significant realized capital gains. The NEIP investments which are allocated to the short-term, mid-term and long-term investment strategies returned 6.0% (2013: 3.5%). During fiscal 2013-14 the allocation to the long-term investment strategy was increased which benefited the aggregate return.

Expense



Total expense amounted to $1,746.2 million and has increased by $43.8 million over the prior year.

Salaries and benefits

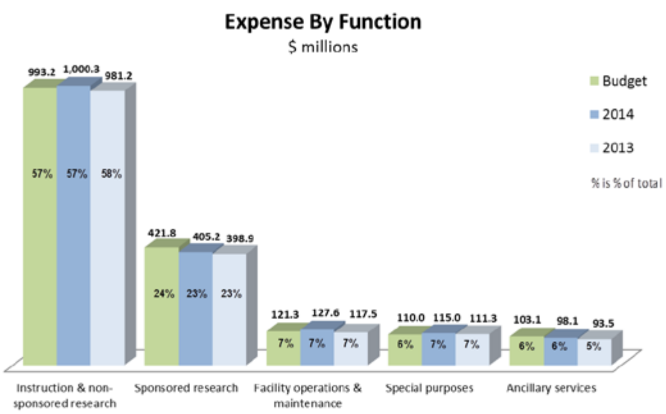
Salaries and benefits are the university's largest expense representing 62% of total expense. Salaries increased $22.9 million (3%) and benefits increased $8.5 million. The salary expense budget included negotiated salary increases (1.65%) and merit increases for eligible employees. Salary expense is $11.2 million more than budget due to the accrual for the voluntary severance program ($14.7) announced in fiscal 2013-14. Benefits expense is comparable to budget.

Materials, supplies and services, utilities, cost of goods sold (COGS)

Materials, supplies and services expenses are $16.1 million less than budget due to lower than anticipated expenditures in the research fund. Utilities are $3.2 million more than budget due to a higher than budgeted natural gas rate. COGS is comparable to budget.

Other expenses

Maintenance and repairs is $6.3 million (9%) more than budget mainly due to projects that are ahead of schedule. Scholarships and bursaries are $4.0 million (4%) less than budget. This category was budgeted to increase over prior year, however due to the sudden change in the GoA operating grant, which created uncertainty with respect to the university operating funds, some restraint was being exercised at all expenditure levels, including scholarships and bursaries.



Instruction and non-sponsored research

Instruction and non-sponsored research effectively represents the operating activities of the university and therefore a significant component of this category is staff salary and benefit costs. This expense is comparable to budget.

Sponsored research

Expenses for sponsored research activities are specifically funded by restricted grants and donations. This expense is comparable to budget.

Facility operations and maintenance

The cost of maintaining university facilities and grounds is comparable to budget.

Special purpose

Special purpose is non-research activity that is funded though restricted grants and donations and includes student scholarships and bursaries, teaching and learning programs and community service. This expense is comparable to budget.

Ancillary services

Ancillary services include the university bookstore, parking services, utilities and student residences. Ancillary services is $5.0 million less than budget mainly due to lower than planned sales in the bookstore, therefore lower than planned cost of goods sold.

Sponsored Research Contributions

	2014	2013
(in thousands of dollars)		
Government of Alberta grants	$ 133,212	$ 78,585
Federal and other government grants	173,000	164,396
Donations and other grants	86,264	92,476
Investment income	26,012	27,657
Sales of services and products	5,554	6,356
	424,042	369,470
Other research related funding	21,977	20,360
Tri-council indirect cost grant	16,764	16,882
	$ 462,783	$ 406,712

Sponsored research contributions increased by $56.1 million. The increase was mainly due to an increase in GoA grants from Alberta Innovates (Health Solutions, Technology Futures and Bio Solutions).

Other research related funding includes clinical trial funding with Alberta Health Services, this revenue is not reflected in the university's consolidated financial statements.

Net Assets

	2014	2013
(in thousands of dollars)		
Investment in tangible capital assets	$ 493,634	$ 462,233
Accumulated deficit from operations	(89,173)	(76,132)
Accumulated operating surplus	404,461	386,101
Endowments	993,688	879,861
Accumulated remeasurement gains	38,897	14,830
	$ 1,437,046	$ 1,280,792

The university's net asset balance is an important indicator of financial health for the institution. Net assets increased by $156.3 million compared to the prior year. The majority of this increase is due to an increase in endowments and to the university's investment in tangible capital assets.

Endowments

Endowments consist of restricted donations and capitalized investment income which is required to be maintained intact in perpetuity to support donor specified activities. Endowments support a variety of key initiatives in the areas of academic programs, chairs and professorships, research and scholarships. Donations of $20.5 million and capitalizing $93.3 million of investment income are the drivers behind the $113.8 million increase to endowments. Endowment investments generated $137.2 million of income, of which $43.9 million was allocated for program spending and administrative fees.

Capital Planning

The university expended $179.2 million (2013: $178.9) on construction and other capital asset acquisitions. With the recent completion of several large-scale capital projects, the university now has the opportunity to sustainably maintain and, where appropriate, repurpose aging assets and infrastructure as new funding is made available.

The most significant construction and capital asset acquisitions in 2014 are:

- A Pedway connecting various health buildings and the Health Sciences LRT station (in kind grant)
- Physical Activity and Wellness Centre
- East Campus Village for a student residence
- Innovation Centre for Engineering
- Purchase of the Federal Archives Building to house the Book and Record Depository (BARD)

Areas of Significant Financial Risk

The university operates in a complex environment and must deal with a variety of risks which it manages through its integrated enterprise risk management framework. The major risks that can affect the university from a financial perspective are as follows:

Provincial Funding

In fiscal 2013-14 the GoA Campus Alberta grant was reduced by 7.2% ($43 million). Coupled with the anticipated 2% grant increase the net effect was a $55 million reduction in anticipated provincial funding. The Campus Alberta grant was increased mid-year by 2.6% ($14.4 million). The GoA has announced there will be no change to the grant for fiscal 2014-15. GoA grants represent the university's single largest source of funding for university activities, any reduction in the Campus Alberta grant results in significant budgetary pressure.

The university has developed detailed plans and strategies that will achieve a consolidated balanced budget for fiscal 2014-15. With the reduction in operating grant funding, the university will need to generate new sources of revenue and reduce costs.

Pension and Employee Future Benefits

The university currently carries a liability of approximately $250 million for employee future benefits, representing probable future payments to be made for benefits earned to date. This balance can change for many reasons outside the university's control, including inflation and investment returns.

On the whole, the university's cost of benefits is expected to increase by between 5% and 7% per year in the upcoming years and this is not sustainable. Approximately 65% of the university's non-pension benefit costs relate to programs the university and its staff co-operatively manage and which could be changed through negotiation.

The largest of the unfunded liabilities is the university's share of the UAPP, which is approximately $170 million. Both the UAPP and PSPP deficiencies are expected to be eliminated within 15 years, based on conditions at the time of the last actuarial valuations when the new contribution rates were set. However, without structural reforms to the pension plans, the level of pension plan contributions as a percentage of total benefit costs will not be sustainable.

Deferred Maintenance

The university's deferred maintenance is estimated at over $800 million. While the university is making progress on deferred maintenance on its older facilities, the overall amount of deferred maintenance remains relatively unchanged. This area remains a high priority as deferred maintenance puts some risk on the university's programs and initiatives. The continuation of appropriate levels of Infrastructure Maintenance Program funding is needed to avoid a return to increasing amounts of deferred maintenance.