UNIVERSITY OF CALGARY

Management Discussion & Analysis

For the Year Ended March 31, 2012

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Statement of Management Responsibility

The university is responsible for the preparation of the financial statements and has prepared them in accordance with Canadian generally accepted accounting principles as described in note 2 to the financial statements. The financial statements present fairly the financial position of the university as at March 31, 2012 and the results of its operations, changes in net assets, and cash flows for the year then ended.

In fulfilling its responsibilities and recognizing the limits inherent in all systems, the university has developed and maintains a system of internal control designed to provide reasonable assurance that university assets are safeguarded from loss and that the accounting records are a reliable basis for the preparation of the financial statements.

The Board of Governors carries out its responsibility for review of the financial statements principally through its Audit Committee. The Audit Committee meets with Management and the External Auditor to discuss the results of audit examinations and financial reporting matters. The External Auditor has full access to the Audit Committee, with and without the presence of Management.

The financial statements for the year ended March 31, 2012 have been reported on by the Auditor General of the Province of Alberta, the auditor appointed under *The Post-secondary Learning Act.* The Independent Auditor's Report outlines the scope of his examination and provides his opinion on the fairness of presentation of the information in the financial statements.

Original signed by Elizabeth Cannon
President

Original signed by Jonathan Gebert
Vice-President (Finance and Services)

Management Discussion and Analysis Overview

This Management Discussion and Analysis (MD&A) should be read in conjunction with the University of Calgary annual audited financial statements and accompanying notes. The MD&A and audited financial statements are reviewed and approved by the University of Calgary Board of Governors on the recommendation of the University of Calgary Audit Committee. The university's financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are expressed in Canadian dollars.

The MD&A is an overview of the financial results the University of Calgary achieved in the fiscal year ending March 31, 2012 and offers a detailed discussion and analysis of the university's:

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Operating Environment

Throughout the fiscal year ended March 31, 2012, the university continued to operate in a climate of political, economic, social, technological, and environmental change. With the lasting impacts of the global recession resulting in continued fluctuating global markets and government austerity measures, Alberta is fortunate to be one of the leading Canadian provinces in economic growth during this challenging economic time. However, even with the announcement of a 2% increase to the university's operating grant from the government of Alberta, the university has projected that, with the continued inflation of expenses exceeding increases to revenues, the university will experience revenue shortfalls in fiscal years 2013/14 and beyond.

In preparation for these forecasted shortfalls, the university implemented a number of initiatives to improve fiscal responsibility including system and process efficiencies, and future utilities cost saving measures. In addition, continued increases in enrolment and legislatively controlled increases to tuition combined with additional ancillary revenues contributed to the excess of revenues over expenses for the fiscal year.

This year's financial results were not achieved without their challenges. Continued uncertainty in the global financial markets negatively impacted endowment investment earnings during the first six months of the fiscal year. These losses were later recovered in the latter half of the year, but resulted in lower than expected endowment investment income. This endowment investment income shortfall, however was offset by improved cash flow management activities at the university, allowing for increased investment in longer term investments offering higher returns.

Changes to the university's funding environment also impacted capital construction grants with a significant drop from pre-recession funding levels. While the university has focused on completing a number of capital projects that improve the student experience, electricity and heating efficiencies, and learning and study spaces, a critical need to renew and expand our facilities remains to ensure the university continues to increase the use of technology in the classroom and support world leading research facilities.

To capitalize on the challenges and opportunities existing in the university's operating environment, the university released its new strategic direction in the fall of 2011 – a bold and ambitious vision to become one of Canada's top five research universities, grounded in innovative learning and teaching and fully integrated with the community of Calgary by the university's 50th anniversary in 2016. *Eyes High*, our collective strategic direction for the next five years, was developed through a campus wide strategy planning process that reached out to the entire university community – from students, faculty, and staff, to alumni and community leaders.

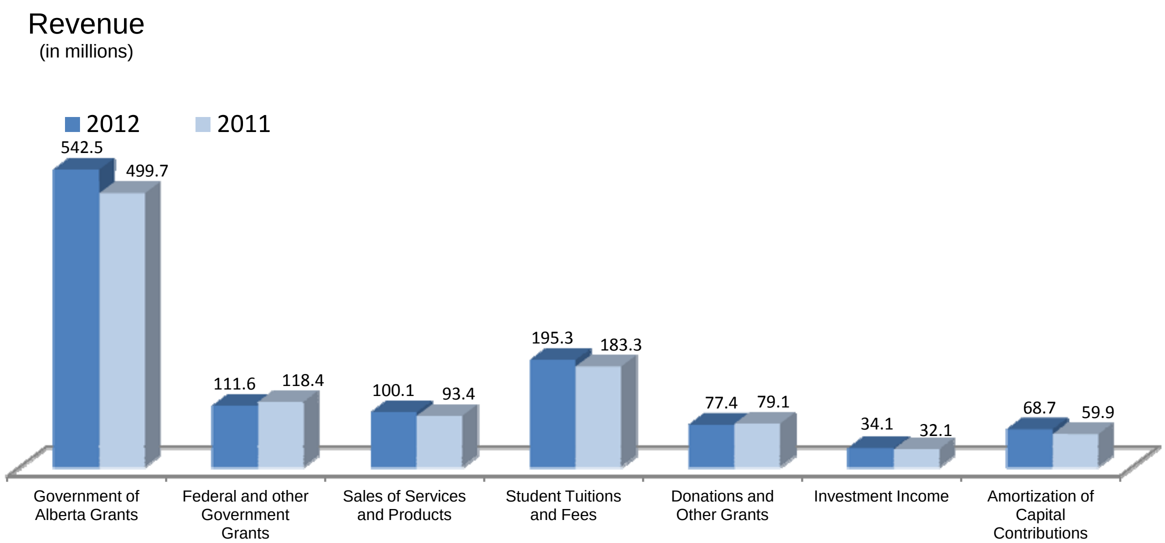
To achieve the university's vision, both the *Comprehensive Institutional Plan* and the *Academic Plan* were developed to guide the allocation of financial, human resources, and capital resources. These plans form the basis for budget decisions that drive the strategic use of university resources to achieve university goals, while supporting fiscal responsibility.

Financial Results

From total revenues of $1,129.6 million for the fiscal year ended March 31, 2012, the university experienced an excess of revenues over expenses of $93.2 million of which $68.3 million has been set aside for future internally funded research, capital, IT, and other project activities. The remaining surplus has been added to the university's Unrestricted Net Asset balance to help support the university in reaching its strategic goals during the 2013/14 and following fiscal years where funding shortfalls are forecasted and to have available funding should significant unplanned expenditures be required.

Revenue

Contributing to the excess of revenues over expenses for the year ended March 31, 2012, the university experienced an increase in revenues of $63.9 million (6%) over the prior year.



Government of Alberta Grants

Revenues from the Government of Alberta represent the university's single largest source of income and play a key role in the university's ability to fund university activities. Even with the province announcing 2% increases to operating grants in future years, forecasted operating expenditure growth rates of 4 to 5% stemming from inflation and projected salary increases will outstrip projected increases in the operating grant received from the province. This will result in forecasted revenue shortfalls and increased reliance on other funding sources such as Student Tuition and Fees, and Sales of Services and Products.

Government of Alberta Grants increased by $42.8 million over the prior year due to a combination of increases to the university's operating grant ($5.6 million), additional funding relating to increased enrolment and specific program initiatives ($4.0 million), grants to cover operating expenses previously funded by Alberta Health Services ($9.7 million), and one-time funding that will not be available in future years ($8.0 million). Additionally, the university recognized an increase of $10.3 million in Government of Alberta funded research revenues in addition to an increase in funding for other projects of $5.2 million.

Compared to the prior year, provincial capital funding decreased by $50.6 million as a result of capital expansion programs funded by the provincial government nearing completion. Given capital grants are recognized into revenue over the life of the capital assets purchased and constructed, this drop in funding does not result in a drop in revenues recognized in the current year. It does, however, represent a significant change in funding from the province. Capital renewal and upgrading remains an important component to achieve the university's *Eyes High* vision because of the paramount importance of the learning, teaching and research environments of the university.

Federal and Other Government Grants

Although Canada's economy has performed better than other nations during these times of global economic uncertainty, the Government of Canada is not immune to austerity measures to balance its budget. During the year ended March 31, 2012, the university experienced a $6.8 million decrease in Federal and Other Government Grant revenues relating mainly to research initiatives.

Sales of Services and Products

The university continues to develop alternative sources of revenue to fund forecasted budgetary shortfalls while improving the student experience and support to our faculty and staff. Sales of Services and Products revenues increased by $6.7 million over the prior year. Main driving factors for this increase in revenue include $3.2 million in additional revenues relating to the new Yamnuska student residence, and $1.6 million in increased revenues earned through providing services in support of university employees who have medical practices.

Student Tuition and Fees

Student Tuition and Fees are another important component of the university's funding of educational goals. During the year, Student Tuition and Fees increased by $12.0 million mainly due to a combination of $5.0 million in enrollment growth and the Government of Alberta Tuition Policy allowing for a 0.35% increase in tuition, $3.4 million in additional student fees received, $1.3 million in increased tuition differential fees from international students, and $1.0 million from increased demand for non-credit Continuing Education programs.

Comparative analysis of student enrolment:

(Unaudited) Student Enrolment *	**2012**	2011	Net Change	% Change
Undergraduate	**25,278**	24,586	692	3%
Graduate	**6,049**	5,890	159	3%
Total Student Enrolment	**31,327**	30,476	851	3%

* Fall Semester figures

Investment Income

While investment income revenues increased by $2.0 million over the prior year, the university's endowment investments suffered losses during the first six months of the fiscal year. Although these losses were recovered through improved endowment investment performance in the latter half of the fiscal year, endowment investment income recorded was $7.3 million less than the prior year.

Investments held for working capital requirements (non-endowment investments) experienced improved performance over the prior year due to a combination of changes to global interest rates pushing up the value of interest bearing investments and improved cash flow management processes at the university that allowed for increased investment into longer term interest bearing investments. These two factors, combined with the university's share of subsidiary and joint venture activities, resulted in increases to investment income of $6.9 million.

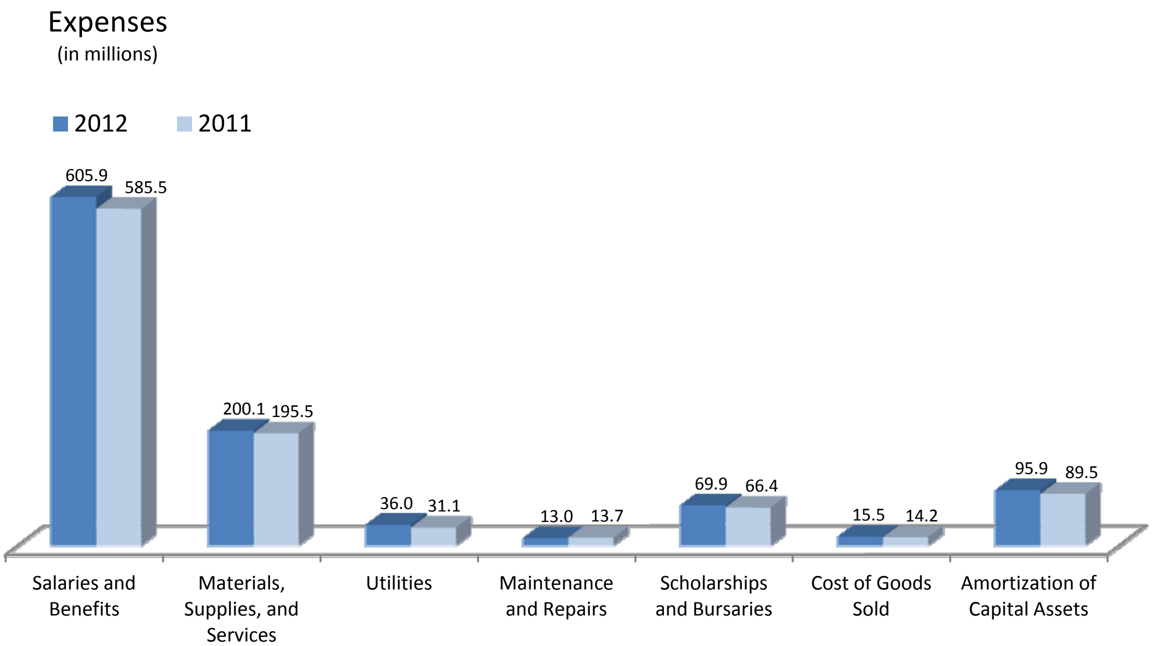
In addition to the improvement in working capital investment income, the investment income amounts deferred from revenue for use in future years declined by $2.9 million from the prior year, resulting in increased investment income.

Amortization of Capital Contributions

When capital contributions are spent on capital purchases and construction, the grant and donation amounts received are recognized into revenue over the useful life of the related asset. The $8.8 million increase in Amortization of Capital Contributions is the result of completing several new buildings on campus including the Cogeneration Plant (power and heat generation facility), the Energy, Environment & Experiential Learning building, and the Taylor Family Digital Library.

Expenses

For the year-ended March 31, 2012 the university recorded $1,036.4 million in expenses representing an increase of $40.5 million compared with the prior year.



Salaries and Benefits

From instruction in classrooms and research activities, to the maintenance of the university's buildings and grounds, university faculty and staff make our goals a reality. In this regard, salaries and benefits are the largest expenditure component at the university, representing 58% of the institution's expenses. Increases in salary and benefit rates are an important consideration when forecasting changes in university expenditures, especially when increases in operating grant rates are not sufficient to cover the increase in employee pay rates that are often governed by union and faculty agreements. In addition, with Alberta leading Canada in economic growth, the university has experienced continued salary cost pressure to compete in Calgary's labour market.

When compared with the prior year, Salaries and Benefits have increased by $20.4 million. Salary increments including merit and other increases represent $7.6 million of this increase. In addition, salary costs increased by $9.7 million as a result of additional costs being incurred by the university that were previously incurred by Alberta Health Services. These additional costs were funded by increased grants from the province. Remaining increases were mainly the result of increased employee banked vacation costs of $2.0 million related to increased salary rates and deferred vacation plans.

Materials, Supplies and Services and Other Expenses

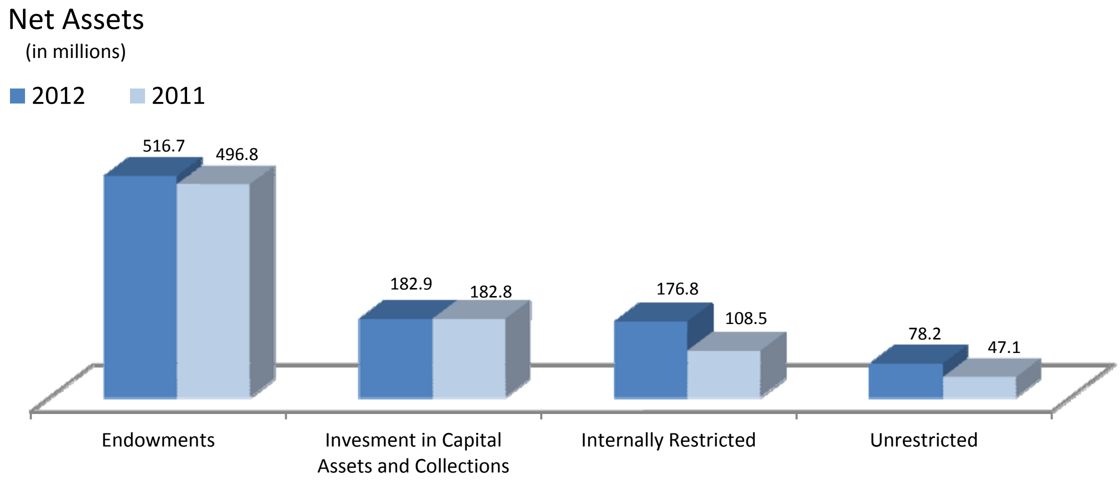
With half of the increase in expenditures relating to Salaries and Benefit increases, the remaining expenditures either increased slightly or remained relatively constant compared to the prior year. The $4.6 million increase in Materials Supplies, and Services followed inflationary trends with expenditure growth representing a 2.3% increase from the prior year.

Utilities expense increase of $4.9 million was mainly the result of a $4.0 increase in electricity costs stemming from higher electricity rates and the completion of new buildings on campus. In January 2012, the university's Cogeneration Plant became operational which helped reduce electricity costs in the latter part of the fiscal year.

Amortization expense also increased for the fiscal year by $6.4 million due to the completion of capital expansion projects during the year. Remaining variances to Maintenance and Repairs, Scholarships and Bursaries, and Cost of Goods Sold did not contribute significantly to the increase in university expenses for the fiscal year.

Net Assets

The university's net asset balance is an important indicator of financial health for the institution. Through financial planning and decision making combined with increased endowment contributions from donors, the university's net assets increased by $119.3 million compared to the prior year.



The majority of this $119.3 million increase resulted from the university's excess of revenues over expenses of $93.2 million. Of this balance, the Board of Governors has internally restricted $68.3 million to be set aside for future internally funded research, capital, IT and other project activities. The remaining surplus has been added to the university's Unrestricted Net Asset balance to help support the university in reaching its strategic goals in future years where funding shortfalls are forecasted and to have available funding should significant unplanned expenditures be required. Remaining increases to net assets are due to endowment contributions received of $25.9 million and endowment investment income shortfalls of $6.0 million, which resulted in a net increase in Endowment net assets of $19.9 million.

Capital Planning

As the university continues to grow and reach for its *Eyes High* strategic vision, there remains a critical need to renew, alter and expand our facilities. In 2012, the university expended $182.5 million (2011 - $351.3 million) on construction and other capital assets. This drop in capital activity was the result of completing a number of capital projects that commenced in prior years, as well as due to the university adapting to changes in provincial government funding where capital grants from the province were reduced by $50.6 million from the prior year.

Changes in the provincial government's funding strategies have an immediate impact on capital construction activities. The university understands that to remain competitive and reach its goal of becoming one of Canada's top five learning and research institutions, the university requires leading edge technology in the classroom and within its research facilities.

The following significant capital projects were completed during the year:

Energy, Environment & Experiential Learning (EEEL) – Through new and existing facility development, the EEEL project offers new and upgraded spaces for undergraduate laboratories, classrooms, seminar rooms, group and individual study spaces and research laboratories. The EEEL main building is completed and occupied, with the exception of the fifth floor space that is still under development. It is anticipated that the EEEL building will achieve or exceed Leadership in Energy and Environmental Design (LEED) Gold standards.

Taylor Family Digital Library (TFDL) – The new state-of-the-art learning and research centre, opened in September 2011, has become a new gathering place for students, faculty and staff. The library provides access to print, digital and university museum collections, as well as teaching, learning, research and support services in a consolidated and integrated manner. The TFDL is seeking LEED gold certification.

Yamnuska Hall – In September 2011, Yamnuska Hall welcomed its first students to the 600 bed undergraduate residence facility. In addition to accommodation facilities, the building is complete with retail lease space on the main level and is host to conference attendees and sports facility users during the summer months.

Cogeneration Plant – The central heating and cooling facility upgrade is a major piece of the university's commitment to sustainability. The new facility takes the natural gas component and uses it to run a gas turbine that generates electricity. The heat produced by the turbine is in turn used for heating buildings. It will cut CO^2 emissions by 80,000 tonnes annually and reduce operating costs by more than $3.0 million each year. The plant was in full operation in January 2012.

Areas of Significant Financial Risk

Deferred Maintenance

The university directs significant amount of resources towards renewing and altering older existing facilities to ensure that these facilities are updated with relevant technology, operate efficiently, and meet contemporary standards. Provincial funding has had a measurable impact slowing the growth rate of outstanding deferred maintenance. However, the current rate of funding is insufficient as the university's deferred maintenance currently exceeds $392.0 million as assessed by Alberta Infrastructure.

Unfunded Pension Liability

The university participates with other Alberta post secondary institutions in the Universities Academic Pension Plan (UAPP) to provide pensions for participating faculty and staff. The extrapolated actuarial deficiency for the pension plan at March 31, 2012 was $1,153 million of which the university's portion was $156.2 million (2011 - $119.8 million). This unfunded deficiency in the UAPP is currently being funded by the Government of Alberta and employee and employer contributions in order to eliminate the unfunded deficiency by December 31, 2043.

Other employees at the university participate in the Public Sector Pension Plan (PSPP). Given the large number of employers participating in PSPP and the resultant complexities in calculating accurate information relating to each participant's share of any unfunded liability, employers were unable to isolate their portion of the total unfunded deficiency at December 31, 2011 of $1,790 million (2010 - $2,067 million). This unfunded liability represents a risk that both employer and employee contribution rates could increase in the near future.

Budgetary Pressure

Although the university has a balanced budget for 2012/13, forecasted funding shortfalls for subsequent years are projected due to a number of risk factors. While the university is pleased with the province's announcements of commitment to post-secondary education along with the announced 2% increase in operating funding, this increase is not sufficient to cover costs which are escalating at a higher rate. For example, salary and benefit expenses, which are influenced by Calgary's growth economy and represent a large component of the university's expenditures, increased at a rate of 3.5% over the prior year. In addition, the university's deferred maintenance continues to grow in an environment of decreasing capital grant funding.

While the increase in operating funding will cover a portion of these increasing costs, legislatively mandated ceilings on tuition increases limit the university's ability to bridge the funding gap through more traditional means. As a result, the university continues to search for and implement efficiencies, such as the building of the Cogeneration Plant, to reduce the impact of these rising costs while working closely with the Board of Governors and the government to develop financial strategies that will ensure our *Eyes High* vision and goals are reached.

Future Accounting Standard Changes

Starting in the upcoming 2012/13 fiscal year, all of Alberta's post-secondary institutions will be changing accounting standards from the previous Not-For-Profit Accounting Standards to Public Sector Accounting (PSA) Standards.

In preparation for this change, the University of Calgary is participating on the provincial working group with the Government of Alberta and other Alberta colleges and universities. The goal of the working group is to assist institutions in developing and implementing their transition to the PSA Standards.

Phase I of the transition included identifying and analyzing potential high impact transition topics in the context of the post-secondary environment. In Phase II, the working group will continue to analyze transitional impacts as the group develops the financial statement templates for the post-secondary education sector that comply with PSA Standards while ensuring information presented in future financial reports supports effective decision making.

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