UNIVERSITY OF
CALGARY

Management Discussion & Analysis

For the Year Ended
March 31, 2013

TABLE OF CONTENTS

Statement of Management Responsibility

The University is responsible for the preparation of the financial statements and has prepared them in accordance with Canadian Public Sector Accounting Standards as described in note 2 to the financial statements. The financial statements present fairly the financial positions of the University as at April 1, 2011, March 31, 2012 and March 31, 2013 and the results of its operations, remeasurement gains and losses and cash flows for the years ended March 31, 2012 and March 31, 2013.

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 years ended March 31, 2012 and March 31, 2013 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 (university) 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 Public Sector Accounting Standards 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, 2013 and offers a detailed discussion and analysis of the university's:

1. Operating Environment
2. Transition to Public Sector Accounting Standards
3. Financial Results
4. Net Assets
5. Capital Planning
6. Areas of Significant Financial Risk

Operating Environment

The University of Calgary has undergone a dramatic financial turnaround over the past few years. In fiscal year 2009, the university had a negative unrestricted net asset balance of $57.6 million. Thanks to tremendous discipline and hard work within the institution, we improved our financial situation and by the 2011 fiscal year, the University was in a positive unrestricted net asset position. This work positioned the University to embark on the bold vision for the future laid out in the Eyes High Vision. To support attainment of this vision, a new budget model was developed and implemented within the University this year. This new model incents the achievement of the outcomes of the Academic and Research Plans and aligns closely with the increased focus on results-based budgeting within the Government of Alberta.

The attainment of the Eyes High Strategic Vision and fulfillment of the associated value proposition for the province of Alberta was predicated on a stable funding environment. The 7.3% cut announced on March 7, 2013 to the post-secondary sector is a departure from the stable funding environment that the province committed to in 2012. At the University of Calgary, we are receiving $41.0 million less than expected in our Campus Alberta Grant, and $6.0 million less than expected in our Infrastructure Maintenance Program funding. While our new budget model places us in a strong position to adjust to new financial realities, this substantial cut will decrease our economic impact on the regional economy, and result in significant impacts to people, programs, enrolment, number of classes offered, operations, and research productivity. On the other hand, a budget cut of this magnitude produces opportunity – and we are currently exploring options of re-imagining the university, and over the next six months will conduct in-depth analysis of over 200 ideas that have been submitted by our academic community. Despite the financial cuts, we will spend $1,178.1 million dollars in strategic ways to advance the University of Calgary – and the Province of Alberta.

Transition to Public Sector Accounting Standards

For the fiscal year ended March 31, 2013, the University of Calgary, along with all post-secondary institutions in Alberta, transitioned from Not-for-profit Accounting Standards to Public Sector Accounting (PSA) Standards. This transition was effective for the fiscal year commencing April 1, 2012 with comparative information shown in the financial statements from April 1, 2011 onwards.

Employee Future Benefits Transition Adjustment

Accounting transitions can offer unique one-time opportunities to adjust and align financial reports to include items that were historically excluded through following previous accounting standards – in turn creating a fresh start to reflect accounting balances in compliance with the new accounting standards. This does not bring into question the correctness of previous information, given prior year financial information was prepared following the required standards; the transition results in options for adjusting how balances are shown from the transition date (April 1, 2011) onwards.

The transition to PSA Standards had a number of elections available to the University. One significant election related to recognizing the net unamortized actuarial losses associated with the University's employee future benefit plans against Accumulated Surplus at the accounting transition date of April 1, 2011. These unamortized actuarial losses represent pension, long-term disability, and administrative leave obligations that have yet to be recorded as a liability on the financial statements. These actuarial obligations normally become liabilities over time as they are recorded as expense. It is important to note that the actuarial obligations were disclosed in the financial statements in prior years and was an acceptable and required practice.

At April 1, 2011, the University employee future benefits had a combined unamortized actuarial loss of $59.9 million. This actuarial loss represents the difference between the various plan deficits and the university's liability present in the statement of financial position. Without taking this election to record the balance into Accumulated Surplus, this actuarial loss would result in increased pension expense of $5.9 million each year over roughly a 10 year period. By choosing to record this $59.9 million actuarial loss as an increase to liabilities and reduction of Accumulated Surplus retroactively at April 1, 2011, the university feels this best represents the true nature of employee future benefit liabilities at the transition date. This election and related adjustment however, is only a one-time adjustment as the result of the transition to PSA Standards and is not available on actuarial losses incurred on employee future benefit plans after April 1, 2011.

By electing to make this adjustment, and in combination with other non-significant transition adjustments to unrestricted net assets disclosed in Schedule 1 to the financial statements, the university's unrestricted net assets have been adjusted from previously reported balances as follows:

- April 1, 2011 opening balances have been adjusted from $47.1 million to $(11.8) million; and,
- March 31, 2012 ending balances have been adjusted from $78.2 million to $24.3 million.

Transition Impacts to Investment Income

Under the university's prior Not-for-profit (NPO) Accounting Standards, investment income reported in the financial statements did not differentiate between realized and unrealized gains on investments. Regardless of whether the university chose to hold or sell an investment, the increase in the value of the investment was recorded as income, except where deferred due to external restrictions, or capitalized into endowed net assets. Under PSA Standards, investment income can only be reported when realized (e.g. upon the sale of the investment). In addition, PSA Standards do not allow retroactive removal of prior year unrealized investment income present in comparative investment income amounts. As a result, the investment income reported for 2013 is not directly comparable to investment income shown for 2012. The impact of this difference is discussed later in the Financial Results section of the MD&A.

Transition Impacts to Expense Presentation

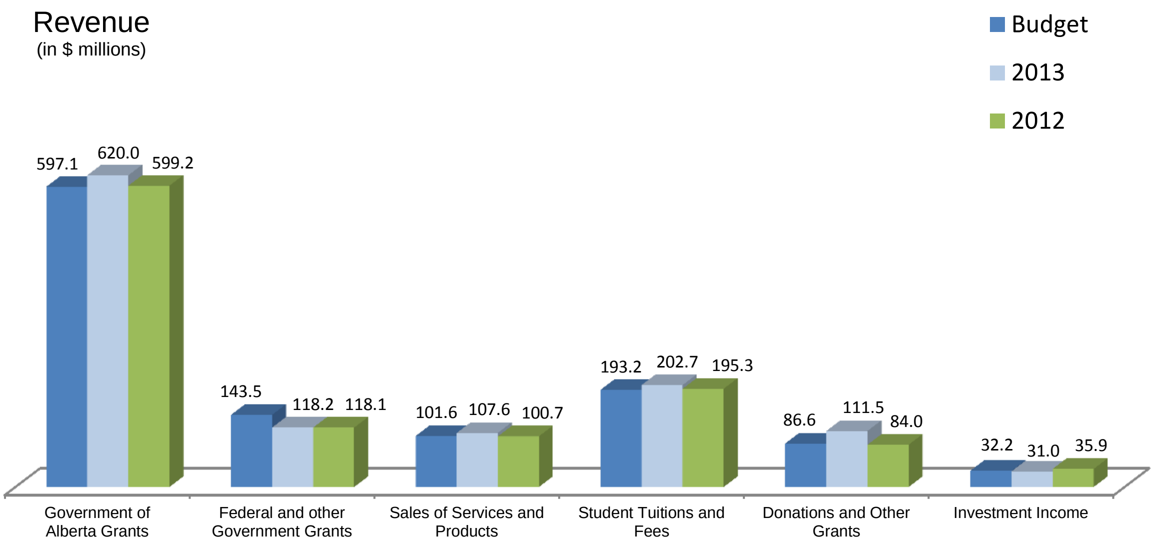
PSA Standards require expenses to be disclosed in two formats – expense by object and expense by function. Expense by object represents the more traditional view of expenses such as Salaries and Benefits, Materials and Supplies, etc., where expense by function shows expenses grouped by main activities such as Academic Costs and Institutional Support, Research, and Facilities Operations and Maintenance. As a result of presenting and disclosing expenses in these two formats, the Management Discussion and Analysis includes variance information following both methodologies.

Financial Results

From total revenues of $1,191.1 million for the fiscal year ended March 31, 2013, the university experienced an excess of revenues over expenses of $94.5 million of which $18.5 million was used for net purchases of capital assets including $4.4 million repayment of debt held by the university. In addition, $43.2 million of the surplus 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 in future fiscal years of funding uncertainty.

Revenues

Contributing to the excess of revenues over expenses for the year ended March 31, 2013, the university experienced an increase in revenues of $57.9 million (5.1%) over the prior year and $37.0 million (3.2%) over the budget.



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 ability to fund university activities. Government of Alberta Grants increased by $20.8 million over the prior year and were $22.9 million greater than budget due to an $8.6 million increase to the university's operating grant and $4.1 million in additional one-time funding targeted at specific institutional initiatives. Additionally, the university realized a $4.8 million increase in revenues recognized from deferred capital revenues as a result of provincially funded buildings being brought into service during the latter part of the prior fiscal year and the current fiscal year. Remaining increases to Government of Alberta Grants relate to increased revenues recognized from deferred research revenues as a result of increased Research activity during 2013.

Federal and Other Government Grants

Although there were no significant differences in Federal and Other Government Grants compared to the prior year, current year revenues were $25.3 million less than budgeted. The university had expected increased Federal and Other Government Grant contributions relating to research activity, however contributions from major Federal research granting agencies decreased by $3.7 million. This decrease in contributions was offset by increased revenues recognized from prior year deferred amounts due to increased Research spend activity.

Sales of Services and Products

As in prior years, the university continues to develop alternative sources of revenue to fund future budgetary shortfalls while improving the student experience and support to our faculty and staff. Sales of Services and Products revenues increased by $6.9 million over the prior year and was $5.9 million higher than budget. These higher than expected revenues were mainly due to additional residency occupancy and general rent increases ($1.1 million), increased parking services revenues ($1.1 million), additional revenues from Hotel Alma ($1.0 million) with the remaining variances due to overall increases in facility rentals, catering, food service space rentals, and royalties.

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 $7.4 million over the prior year resulting in an excess over budgeted amounts of $9.5 million.

The increase from the prior year was mainly due to $6.3 million in enrolment growth combined with the 1.45% increase to tuition in line with the Government of Alberta Tuition Policy, $1.6 million increase in program differential fees, $1.0 million in additional student fees received, $1.0 million in increased tuition differential fees from international students, partially offset by increased tuition deferrals at year end due to increased number of winter semester teaching days after year end for which tuition was previously paid.

Comparative analysis of student enrolment:

(Unaudited) Student Enrolment *	**March 31, 2013**	March 31, 2012	Net Change	% Change
Undergraduate	**25,783**	25,278	505	2.0%
Graduate	**6,019**	6,049	(30)	(0.5%)
Total Student Enrolment	**31,802**	31,327	475	1.5%

* Fall semester figures

Donations and Other Grants

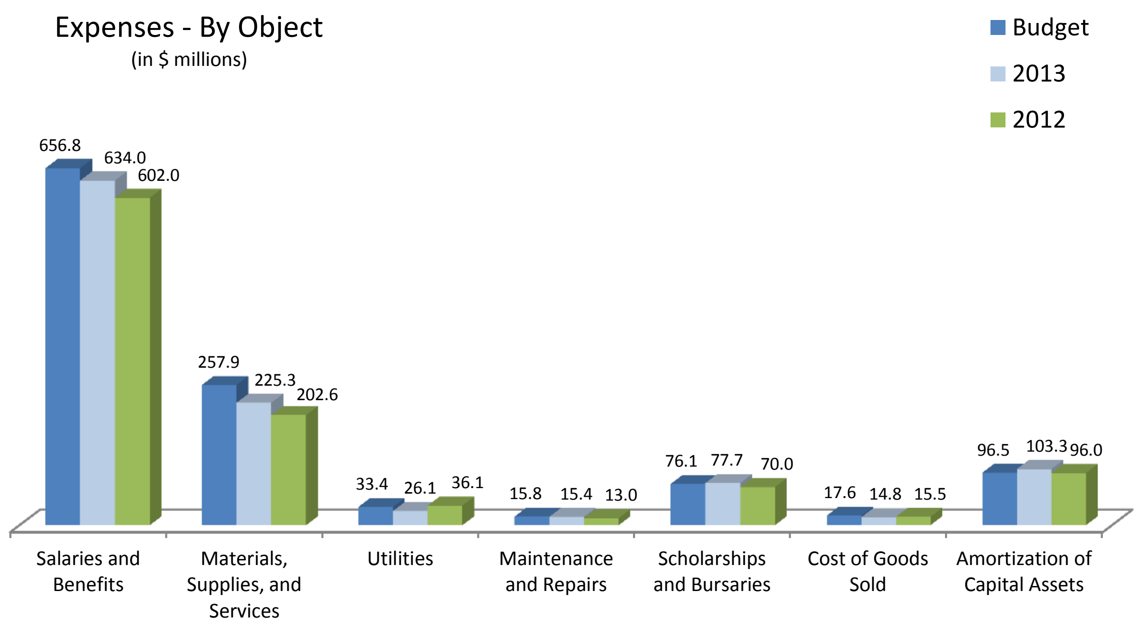
Donation and other grant revenues outperformed both budgeted expectations and prior year results by $24.9 million and $27.5 million respectively. This increase is largely due to $23.9 million in additional donations and other grants received by the Faculty of Medicine during the year for research activities and other donor directed initiatives such as Healthy Child Uganda, Post Graduate Medical Education expansion, Rural Rotations, and the Hotchkiss Brain Institute initiatives.

Investment Income – Including Government Business Enterprises

While investment income revenues did not vary significantly from budgeted amounts, investment income recorded in the financial statements dropped by $4.9 million compared to the prior year. Due to transition standards not allowing retroactive application of removing unrealized gains and losses from the income statement, $11.3 million in unrealized investment gains ($6.9 million relating to endowment investments and $4.4 million relating to working capital investments) experienced during the 2013 fiscal year were not included in investment income. As a result, once adjusting for transition differences, investment returns outperformed prior year results by $6.4 million. In addition, $2.3 million from Government business enterprises was mainly due to start up costs associated with the West Campus Development Trust and related land development activities.

Expenses

For the year-ended March 31, 2013 the university recorded $1,096.6 million in expenses representing an increase of $61.4 million (5.9%) over the prior year and $57.5 million (5.0%) less than budget.



Salaries and Benefits

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 continuing to lead 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 $32.0 million. Salary cost increased by $14.9 million while the increases to benefit costs are $17.1 million. The primary driver of the increase in salary costs are due to salary increments including merit and market increases. Benefit costs had a proportionately larger increase due to an $8.3 million increase in University Academic Pension costs, $2.5 million increase in Public Service Pension Plan costs, $1.2 million in increased employment and extended health care insurance, $1.1 million increase in flexible health spending account costs due to a change in the university's benefit plan options for employees, $1.0 million increase in Canada Pension Plan Costs, with remaining variances due to an overall increase in salary costs.

In comparison to the budget, Salaries and Benefits were $22.9 million less than expected. Of this total variance, $19.9 million relates to less than expected salary costs due to the combination of budgeted staffing positions and plans being implemented later than expected or deferred, combined with vacant positions that occur naturally throughout the year. The budgeted benefit costs included amounts for the pension and other benefit increases noted above, however were $3.0 million lower than budgeted amounts relating to less than expected salary costs.

Materials, Supplies and Services

Materials, Supplies and Services represents the second largest expense component for the university with current year costs being $32.6 million less than budget, but $22.7 million higher than prior year costs. The budget variance is mainly due to delays in spending on specific initiatives and unspent contingencies originally budgeted for in Materials, Supplies and Services, including, $7.6 million less than expected spending on system enhancement projects, $9.0 million relating to the delayed commencement of Post-Doctorate hires in support of the Eyes High Strategic Vision and $5.9 million less than budgeted spend relating to the IT backbone improvement initiative. In addition, included in the budget was $12.2 million of contingency funds that remained unspent at year end.

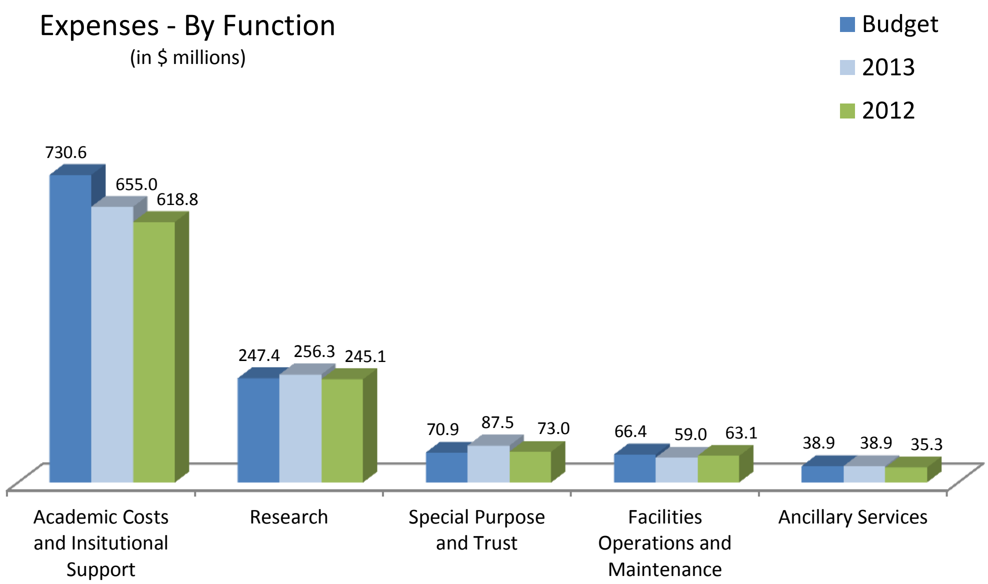
Of the $22.7 million increase over the prior year costs, $5.3 million relate to increased sub-grant costs to other research institutions, $4.6 million is the result of increased IT maintenance, software, and implementation costs, $3.8 million in increased faculty spend with the remaining increase due to inflationary pressures and general across the institution spending increases.

Utilities

Utilities expense was $7.3 million less than budget and $10.0 million below prior year costs as a result of the cogeneration facility, which was completed in January 2012. Being fully operational throughout the fiscal year resulted in reduced heating and electricity costs for the university. The cogeneration facility has reduced net electricity purchase consumption by 67.9% over the prior year. In addition, overall electricity rates decreased by 17.8% with natural gas prices paid by the university also decreasing by 26.2% compared to the prior year.

Maintenance and Repairs, Scholarships and Bursaries, Cost of Goods Sold and Amortization

Scholarships and Bursaries experienced a $6.3 million increase in Graduate Assistantships costs in line with budgeted expectations. Amortization expense was $6.7 million more than budget and $7.3 million above prior year costs due to the completion of capital expansion projects in the latter part of the prior fiscal year and during the current fiscal year. Remaining variances to Maintenance and Repairs and Cost of Goods Sold did not contribute significantly to the overall increase in university expenses for the fiscal year.



Academic Costs and Institutional Support

Academic Costs and Institutional Support represents the single largest function at the university, representing teaching, non-research academic and administrative support activities, effectively representing the operating activities of the university. With this function representing such a significant component of the university's activity, the $36.2 million increase in costs over the prior year represents the function's proportionate share of the university's salary and benefits and materials, supplies and services increases.

In comparison to the budget, Academic Costs and Institutional Support was $75.6 million less than expected. One of the key drivers for this variance include $30.5 million in lower than budgeted salaries and benefit costs due to delayed hiring and unexpected vacancies. This variance is partially offset on an institutional basis by higher than budgeted salary and benefit costs experienced in the Special Purpose and Trust function. The remaining variance is due to delays in spending on specific initiatives and unspent contingencies including, $7.6 million less than expected spending on system enhancement projects, $9.0 million relating to the delayed commencement of post-doctoral hires in support of the Eyes High Strategic Vision and $5.9 million less than budgeted spend relating to the IT backbone improvement initiative. In addition, included in the Academic Costs and Institutional Support budget was $12.2 million of contingency funds that remained unspent at year end.

Research

Research costs were $8.9 million higher than budget and $11.2 million higher than prior year costs. This variance is mainly the result of $5.3 million increase in research related sub-grant expenses with remaining across the board increases related to ramping up of Research activity in support of the university's Eyes High Strategic Vision.

Special Purpose and Trust

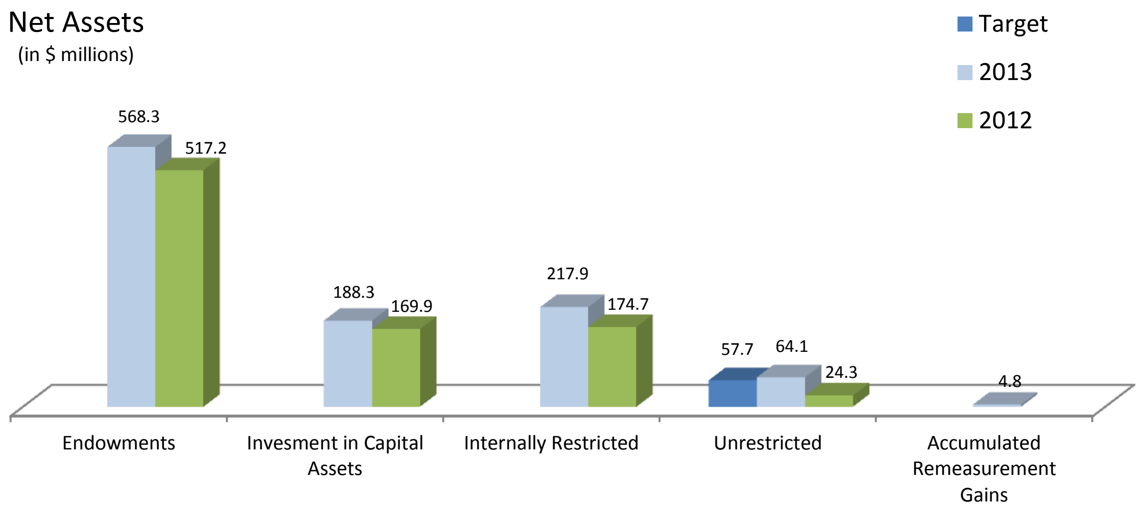
The Special Purpose and Trust expense function represents non-research activity that is funded through externally restricted/specifically directed funds. Special Purpose and Trust experienced across the board increases in spending resulting in costs exceeding budget and prior year amounts by $16.6 million and $14.6 million respectively. The budget variance is comprised of $8.0 million higher than expected Salary and Benefit Costs, $3.4 million greater than budgeted Materials and Supplies, and $2.0 million in increased travel costs mainly for specific externally funded initiatives undertaken by the Faculty of Medicine related to Healthy Child Uganda, Post Graduate Medical Education expansion, Rural Rotations, and the Hotchkiss Brain Institute. In addition, externally funded scholarship costs were $2.3 million higher than budget due to increased scholarship activity funded by externally restricted contributions.

Facilities Operations and Maintenance, and Ancillary Services

Costs relating to operating and maintaining university facilities and grounds were $7.4 million less than budget and $4.1 million less than the prior year due to lower utility costs of $9.9 million partially offset by $2.4 million increase in maintenance and repairs costs and general salary and benefit cost increases. Although Ancillary Services costs experienced a $3.6 million increase over prior year amounts, the increase represented budgeted expectations relating to general increases in costs in support of targeting increased revenues, combined with a $1.1 million increase in amortization costs resulting from newly built residence and other ancillary space coming into service.

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 $157.2 million compared to the prior year.



The majority of this $157.2 million increase resulted from the university's excess of revenues over expenses of $94.5 million. Of this balance, the Board of Governors has internally restricted $43.2 million to be set aside for future internally funded research, capital, IT and other project activities. With the exception of using $18.5 million of the surplus for capital purchases and debt repayment, the remaining surplus has been added to the university's Unrestricted Net Asset balance. The university's target for unrestricted net assets is in line with sector best practice to hold 5% of annual budget. Holding positive net assets provides the university with a buffer for strategic investments and to manage unfavourable variances and general uncertainty. Remaining increases to net assets are due to endowment contributions received of $10.3 million and unrealized endowment investment income of $47.7 million capitalized to endowment balances, less $6.9 million in transfers from endowments to fund endowment spend not covered by realized investment income.

Capital Planning

Continuation of capital expansion and renewal projects remains critical priority for the university. The maintenance and expansion of our facilities contributes not only to the student learning experience and the quality of research activity, but also positively to the Calgary economy. In 2013, the university expended $124.8 million (2012 - $184.4 million) on construction and other capital asset acquisitions. This drop in capital activity represents the completion of capital asset projects that were initiated in prior years as well as the realities of reduced capital funding from the province. For example, having received its last installment of the funding for the Energy, Environment & Experiential Learning building in 2012, 2013 marked a year where the university did not receive specifically targeted capital construction funding from the province.

Major construction activity in 2013 focused on redevelopment and renovation projects, and numerous instructional facility upgrades. Planning and design work also advanced on a number of significant projects in preparation for the start-up of a new building program in the spring of 2013. The following represents progress on significant capital projects during the year:

Energy, Environment & Experiential Learning (EEEL) – Programmatic fit-out activities on the fifth floor continued throughout 2013 with expected completion in early 2014. In addition to two major design awards in 2012, shortly after year-end, the building received Leadership in Energy and Environmental Design (LEED) Platinum certification, confirming the building is one of the most energy efficient laboratory buildings in North America.

Advancing Canadian Wastewater Assets (ACWA) **–** A partnership project between the university and the City of Calgary, with the goal of developing wastewater treatment technologies that will remove existing and emerging contaminants to improve ecosystem and human health. Construction commenced in 2012 is nearing completion with facilities scheduled for commissioning in the fall of 2013.

Science A – Completed shortly after year end, the first phase of work upgraded building circulation and base building improvements. In addition, eleven new classrooms, a new office for the chemistry department, and safety upgrades to the Science Theatres were completed.

Classroom/Facilities Alteration Request – During 2013 work proceeded on improvements to instructional spaces. A total of eighteen projects were completed, making notable headway on improving the instruction environment for students and faculty. These upgrades were further supported by technology upgrades in sixty-two classrooms.

Accommodation Plan Phase 2 – To support the university's Integrated Services Delivery implementation, major support offices have been moved to co-locate on the lower floors of the MacKimmie Library Tower. In addition, the Administration Building is being renovated to meet the current and future needs of the institution. Both projects are underway to bring areas up to current building codes, standards, and contemporary functional layouts.

Areas of Significant Financial Risk

Deferred Maintenance

The university directs a 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 $400 million, an increase of over 30% in the past five years.

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, 2013 was $1,149.2 million (2012 - $1,153.3 million) of which the university's portion is $143.8 million (2012 - $156.2 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 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, 2012 of $1,645.1 million (2011 - $1,790.4 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 2013-14, the university is facing a number of risk factors, most notably communicated zero percent increases in provincial operating funding. Without increases in provincial funding to offset inflationary costs, and combined with legislatively mandated ceilings on tuition increases, the university continues to explore and implement efficiencies and revenue generating opportunities to help bridge the gap between increasing costs and stagnant revenues. While prudent financial management has resulted in recent surpluses that help address this funding issue, budgetary pressures remain a significant risk for the university's strategic direction.