UNIVERSITY OF CALGARY

Management Discussion & Analysis

For the Year Ended
March 31, 2014

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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's Board of Governors on the recommendation of the university's 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, 2014 and offers a detailed discussion and analysis of the university's:

1. Operating Environment
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Operating Environment

The University of Calgary has a strong strategic direction in *Eyes High*, and excellent roadmaps in the Academic Plan and Research Plan that provide strategic priorities that guide the overall allocation of financial, human, and Capital resources. Over the past six years, we have made significant progress with our financial position. Previously, the university had negative $57.6 million in unrestricted net assets, which caused us to set a strategic target to build unrestricted net assets to five percent of the consolidated budget, or approximately $64.0 million by 2016-17. As a result of much work on the part of many people at the university our new performance and results-based budget model developed in the prior year, we have created a sound financial foundation from which to advance *Eyes High*.

In fiscal 2013-14, the government grant for the university was reduced by $31.9 million or 7.3 percent. While this reduction was partially mitigated by a mid-year increase of $10.6 million or 2.6 percent, the cuts that were required to balance the budget in 2013-14 were difficult, and would not have been managed without our financial foundation. While a flat budget with significant one-time funding was welcomed in March 2014, the negative impact of the volatility of government funding continues to be a challenge to achieving our academic and research priorities as the university strives to maintain financial sustainability and stability.

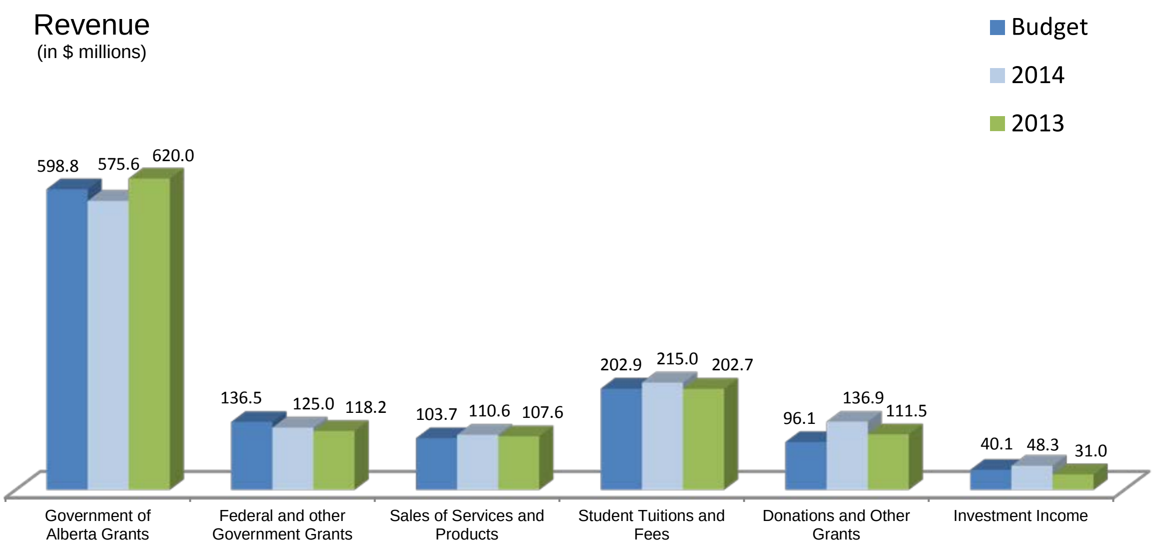
As at March 31, 2014 the university has unrestricted net assets of $72.8 million. This number is positive and allows us to invest strategically to advance *Eyes High* by drawing down our unrestricted net asset balance with targeted one-time strategic initiatives outlined in the Academic Plan and Research Plan. It does not, however, address the issue of the many expenses that require continued or base funding.

Financial Results

From total revenues of $1,211.4 million for the fiscal year ended March 31, 2014, the university experienced an excess of revenues over expenses of $65.7 million of which $17.1 million was used for net purchases of capital assets and $4.9 million repaid debt held by the university. In addition, $34.9 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.

Revenues

Contributing to the excess of revenues over expenses for the year ended March 31, 2014, the university experienced an increase in revenues of $20.3 million (1.7%) over the prior year and $33.3 million (2.8%) 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 decreased by $44.4 million over the prior year and were $23.2 million lower than budget due to a $21.3 million reduction in the university's operating grant, a $14.1 million drop in Post-Graduate Medical Education funding that is expected to be recovered in future years, and a $6.0 million reduction in Infrastructure Maintenance Program funding and net decreases in one-time funded initiatives.

Federal and Other Government Grants

Grants revenues from federal and other government sources were $6.8 million higher than the prior year, but were $11.6 million less than budgeted. While the university experienced a $4.2 million increase in state funding received from Qatar related to the Nursing campus at Qatar and a $2.4 million increase in CFI grants, the university received $10.2 million less funding from major federal research granting agencies which was offset by increased revenues recognized from prior year deferred amounts due to increased research spend activity.

Sales of Services and Products

Through the use of creative and entrepreneurial options, the university continues to develop alternative sources of revenues to fund operations and strategic initiatives. Sales of Services and Products were increased by $2.9 million over the prior year while exceeding budgeted expectations by $6.8 million. This increase over the prior year was mainly due to $2.5 million in additional student residence and parking revenues along with $1.2 million in increased revenues related to services the university provides to medical professionals that were partially offset by a drop in miscellaneous revenues.

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 $12.3 million over the prior year resulting in an excess over budgeted amounts of $12.2 million.

The increase from the prior year was mainly due to $3.6 million in increased student service fees, $2.5 million in increased continuing education revenues from 10.6% increase in enrolment, $1.2 million in international student fees, and $4.7 million in decreased tuition deferrals at year end. This is the result of increased number of winter semester teaching days occurring prior to March 31, 2014 compared to the prior year.

Donations and Other Grants

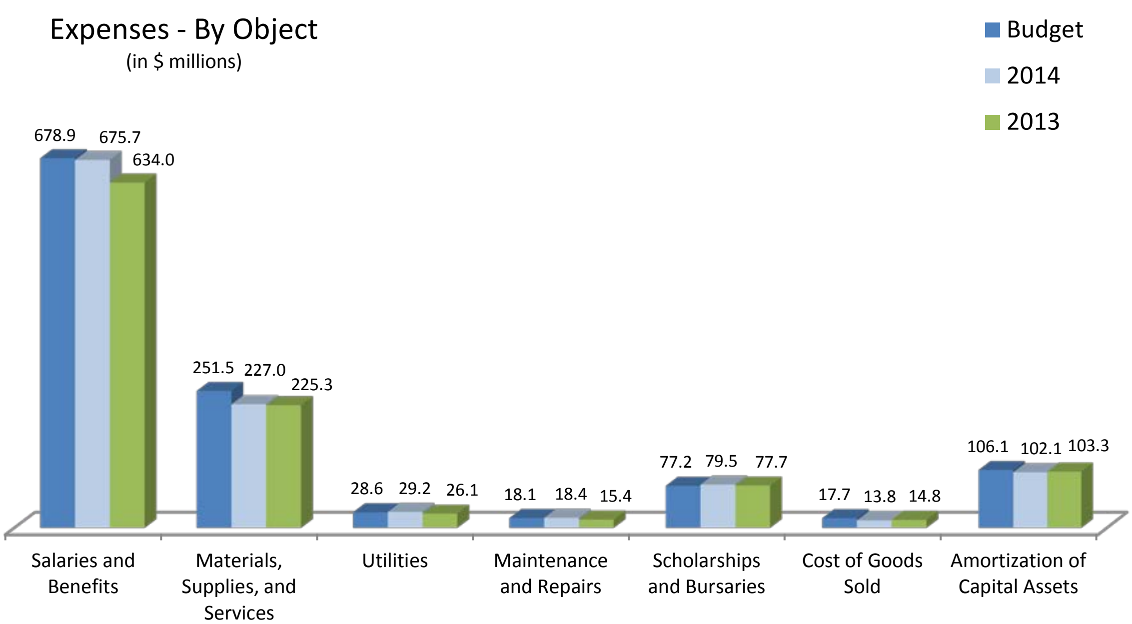
Donation and other grant revenues outperformed both budgeted expectations and prior year results by $40.8 million and $25.4 million respectively. This increase over the prior year is mainly due to increased research expenditures resulting in increased recognition of $15.1 million of donation and other grant revenues that were deferred in prior years. In addition, $8.0 million of increased donations were received, primarily in the faculties of Science, Medicine, Engineering, and Education, with remaining variances due to increases in revenues recognized related to the use of capital assets and buildings funded by donations.

Investment Income – Including Government Business Enterprises

Investment income exceeded prior year amounts by $17.3 million and was higher than budgeted targets by $8.2 million. In 2012-13, the transition to public sector accounting standards resulted in a one year drop in the prior year's investment income as the university was required to move from a fair market value approach to investment income to a realized investment income approach. This one-time $11.3 million drop in the prior year investment income accounts for a significant portion of the variance to prior year investment income results. The remaining variance is primarily due to a roughly $5.1 million gain experienced by University Technologies Inc., one of the universities Government Business Enterprises (GBE) which is partially offset by increased spending by the university's other GBE, West Campus Development Trust. In addition, the university experienced a $1.9 million increase in investment income earned on working capital investments.

Expenses

For the year-ended March 31, 2014, the university recorded $1,145.7 million in expenses representing an increase of $49.1 million (4.5%) over the prior year and $32.4 million (2.8%) less than budget.



Salaries and Benefits

Salaries and benefits are the largest expenditure component at the university, representing 59.0% of the institution's expenses. During the fiscal year, the university continued to experience salary cost pressure from Calgary's labour market. Compensation parity pressures associated with the university residing the province which leads Canada in economic growth continues to be a challenge when making budgeting decisions, especially during times where increases in operating grants do not adequately cover the increase in salaries that are often governed by union and faculty agreements.

While salaries and benefits costs have increased by $41.7 million over the prior year, the costs are $3.2 million less than budgeted. Salary and benefit costs increased by $10.7 million due to new academic, research, and support roles, $3.4 million in Public Service Pension Plan costs, and $1.0 million in temporary and hourly employee wages with the remainder of the variance being primarily due to salary increments including merit and market increases and related impacts to benefit costs.

Materials, Supplies and Services

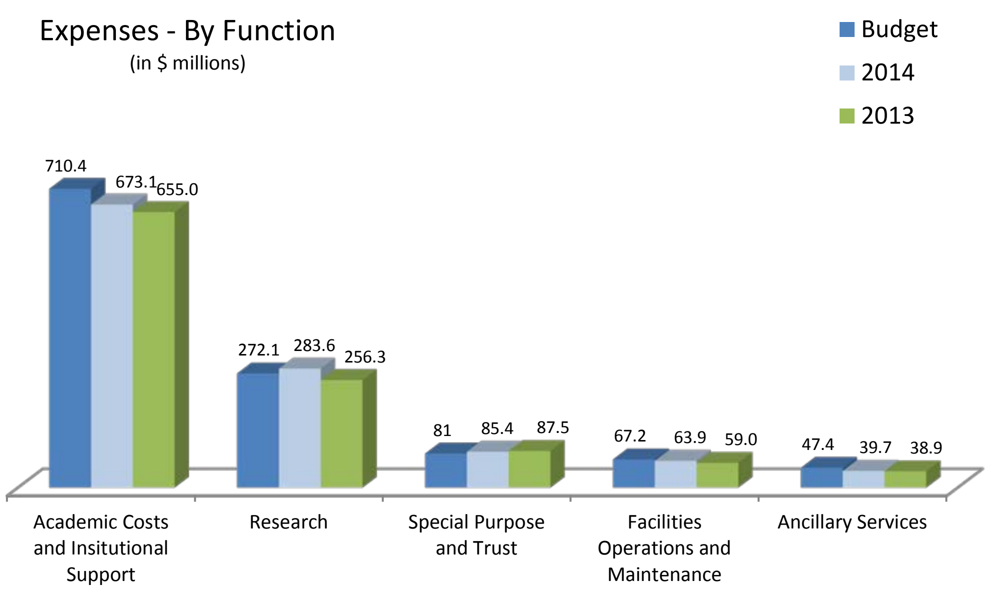
Materials, supplies and services represents the second largest expense component for the university with current year costs being $24.5 million less than budget, and $1.7 million higher than the prior year. The budget variance is primarily due to $29.8 million of contingency funds that remained unspent at year-end that was budgeted for in materials, supplies and services. This variance was partially offset by inflationary pressures.

Utilities

Utilities expense was $0.6 million more than budget and $3.1 million above prior year costs mainly due to additional costs of $1.4 million relating to the cogeneration facility being offline for repairs from December 2013 to March 2014. While the shut-down reduced natural gas consumption, higher offsetting electricity costs were incurred. The remainder of the variance was the result of increased natural gas prices partially offset by reduced consumption leaving additional costs of $0.5 million, increased natural gas and electricity costs of $0.8 million relating to the Foothills campus, and $0.4 million in increased water and sewer costs.

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

Scholarships and bursaries experienced a $1.8 million increase in graduate assistantships costs that were similarly above budgeted expectations but in line with university goals for attracting and supporting students. Maintenance and repairs costs were $3.0 million more than the prior year and within budgeted plans. Remaining variances to amortization 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 instruction, 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 $18.1 million increase in costs over the prior year primarily 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 $37.3 million less than expected, of which $11.4 million has been internally restricted for carryover of faculty and department budget surpluses. The main drivers for this variance to budget include $29.8 million in unused budgeted contingency and $14.7 million less than expected salary and benefit costs that were partially offset by $3.8 million in increased amortization cost associated with internally funded capital acquisitions, $2.3 million in increased scholarship costs paid by operating funds and $2.0 million of foreign exchange losses incurred due to fluctuations in the Canadian dollar.

Research

Research costs were $11.5 million higher than budgeted and $27.3 million higher than prior year amounts. These variances are the result of increased research activity at the university in support of *Eyes High* goals for increasing research. $27.3 million of the increase over the prior year is mainly due to $22.8 million increase in salary and benefit costs associated with additional research activity with remaining variances in the materials, supplies and services category.

Facilities Operations and Maintenance

Facilities operations and maintenance costs for the year were $3.3 million less than budgeted and $4.9 million higher than last year. When compared to prior year amounts, expenditures increases were primarily the result of $3.1 million increased utility costs discussed earlier in the utilities section and $1.3 million in increased salary and benefit costs from merit and market increases and student employee costs relating to the university's sustainability initiative. Although costs increased compared to the prior year, when compared to the budget, the university incurred $2.0 million less than expected salary and benefit costs due to vacant positions that remained unfilled during the year and $1.5 million of unused contingency.

Special Purpose and Trust

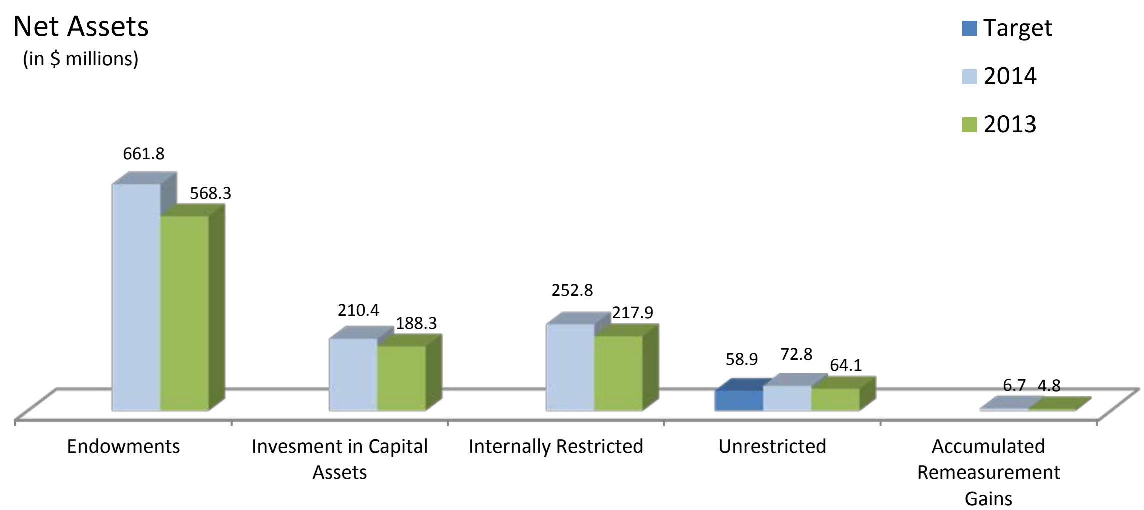
The special purpose and trust expense function represents non-research activity that is funded through externally restricted/specifically directed funds. Although costs are $4.4 million higher than budgeted, expenditures are $2.1 million below prior year amounts mainly due to reduced materials, supplies and services purchased. The higher than budgeted costs were evenly split between higher than expected scholarships and bursaries and materials, supplies and services that, although were less than the prior year amount, were higher than budgeted.

Ancillary Services

Although Ancillary services costs were below budgeted expectations, the costs remained consistent with prior year expenditures with amounts increasing by $0.9 million mainly due to inflationary pressures.

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 and endowment investment gains, the university's net assets increased by $161.2 million compared to the prior year.



A significant portion of this $161.2 million increase resulted from the university's excess of revenues over expenses of $65.7 million. Of this balance, the Board of Governors has internally restricted $34.9 million to be set aside for future internally funded research, capital, IT and other project activities. With the exception of using $22.0 million of the surplus for capital purchases and debt repayment, the remaining surplus of $8.8 million has been added to the university's unrestricted net asset balance. The university's target for unrestricted net assets is 5% of annual budget, in line with sector best practice. Holding positive net assets provides the university with a buffer for strategic investments and to manage unfavourable variances and funding uncertainty. Remaining increases to net assets are due to endowment contributions of $9.2 million, endowment investment gains of $84.3 million capitalized to endowment balances, and $1.9 million increase in unrealized gains on non-endowed working capital investments.

Capital Planning

Continuation of capital expansion and renewal projects remains a 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 2014, the university expended $159.5 million (2012 - $124.8 million) on construction and other capital asset acquisitions. This increase in capital activity represents the continuation of the university's multi-year capital building program and comprised both construction of new buildings as well as redevelopment, renovation, and numerous instructional facility upgrade projects. The following represents progress on the six major construction projects on campus:

Schulich School of Engineering Expansion and Renovation (SSE) – During 2013-14, construction began on this $162.1 million dollar initiative to construct an 18,300 square meter expansion to the Canadian Natural Resources Limited Engineering Complex, along with major renovations to 11,100 square meters to the existing building footprint. The building expansion includes high intensity research labs and support spaces, undergraduate and support spaces, undergraduate engineering teaching labs, group workrooms, low intensity research spaces, and classroom and theatre spaces.

Graduate and undergraduate residences – As part of the university's goal to increase on-campus student accommodation to 15% of undergraduate full-load enrolment by 2022, construction on the $87.5 million project began on a 268 bed upper-year undergraduate residential building and a 390 bed facility for graduate students. Both buildings are targeted for completion by the summer of 2015.

Taylor Institute for Teaching and Learning – The university started construction in 2013-14 to transform the former Nickle Arts Museum site into the $40.0 million Taylor Institute for Teaching and Learning. It will include a simulation centre for teaching research and professional development, multi-purpose facilities to promote collaboration and the sharing of best practices for related research and institutional support teams. This project is targeted for completion in the fall of 2015.

Advancing Canadian Wastewater Assets (ACWA) – This project is a $35.0 million partnership 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. These facilities will be used to demonstrate advanced treatment techniques and the impact of the resultant effluent on the environment.

Science A – The first $18.0 million phase of this project was completed in the early part of 2013-14 with upgrades to the building circulation and base building improvements. In addition, eleven new classrooms and office space, along with safety upgrades to the Science Theatres, were completed.

Classroom/Facilities Alteration Request – During 2013-14, work continued on improvements to instructional and classroom spaces. A total of nineteen projects were undertaken, making notable progress on improving the instruction environment for students and faculty.

Areas of Significant Financial Risk

Deferred Maintenance

The university directs significant resources to ensure university buildings are updated with relevant technology, operate efficiently, and meet contemporary standards. In the past, provincial funding has slowed the growth rate of the university's outstanding deferred maintenance balance of nearly $450 million, however Infrastructure Maintenance Program (IMP) funding from the province was reduced by nearly 40% from the prior year, from $16.0 million in 2013 to $9.9 million in fiscal 2014. While we recognize there are budgetary constraints facing the Government of Alberta, this reduction in IMP funding significantly impacts the university's ability to proactively manage and address this deferred maintenance balance.

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, 2014 was $1,056.9 million (2013 - $1,149.2 million) of which the university's portion is $132.6 million (2013 - $143.8 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 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, 2013 of $1,254.7 million (2012 - $1,645.1 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 2014-15, the university is facing a number of risk factors, most notably funding uncertainty related to provincial operating funding. In our forecasted budgets for 2015-16 and 2016-17, the university has incorporated a 2.0% increase in provincial funding to meet balanced budget targets, however assumed rates of increases to funding remain uncertain. Without these 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.