UNIVERSITY OF CALGARY

# Management Discussion & Analysis

For the Year Ended
March 31, 2015

TABLE OF CONTENTS

# Management Discussion and Analysis Overview

This Management Discussion and Analysis ("MD&A") should be read in conjunction with the University of Calgary's ("the University") consolidated financial statements and accompanying notes for the year ended March 31, 2015. The MD&A and consolidated 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 consolidated financial statements have been prepared in accordance with Canadian Public Sector Accounting Standards ("PSAS") and are expressed in Canadian dollars.

The MD&A is an overview of the University's financial results for the fiscal year ending March 31, 2015 and offers analysis of the University's:

1. Operating Environment
2. Financial Results
3. Net Assets and Liquidity
4. Capital Expansion and Renewal
5. Areas of Significant Financial Risk

# Operating Environment

The University of Calgary is located in one of the country's most dynamic and enterprising cities, the energy capital of Canada – Calgary. The University has earned a reputation for courageous thinking and for attracting exceptional people, with motivated and accomplished staff and students whose talent will guide the University of Calgary to become a global intellectual hub. The University's graduates are community leaders. Over 155,000 alumni have careers in Calgary. Other graduates are located in 147 different countries, making a difference globally.

Through the University's *Eyes High* vision and the priorities articulated in the Academic Plan and Research Plan, a transformation has begun that will greatly enhance the impact of the institution on our city, our province, and society at large. This transformation involves all aspects of the University's educational and research enterprises as well as how the institution engages with communities. These changes position the University of Calgary to be a strategic partner with the Government of Alberta. Through this partnership and with others in Campus Alberta, the University inspires and supports lifelong learning, and fosters a post-secondary system that enhances social, economic, and cultural prosperity.

The University was able to weather the budget cuts of Budget 2013, but not without cost. Budget 2015-16 has brought new challenges for the University of Calgary, including a cut of 1.4% to the University's Campus Alberta grant. Calgary is the largest city in Alberta and the third largest municipality in Canada[1]. It is also the fastest-growing metropolitan area in Canada – with a population expected to reach 1.5 million by 2019. As a result of this anticipated growth, the demand for post-secondary education is on the rise in Calgary.

The University will continue to ensure maximum benefit from the funding it receives. However, the University believes one key to its financial stability is the need for stable and predictable government funding. For the University to be financially sustainable, the Campus Alberta grant should reflect growing demands for accessibility, discovery and innovation, as well as recognize inflationary pressures. Given the provincial emphasis on sustainability, the University's ability to generate revenue will be increasingly important. The University will need to work in partnership with the government to maximize opportunities to increase and diversify revenue streams.

[1] 2011 Census, Government of Canada, Statistics Canada

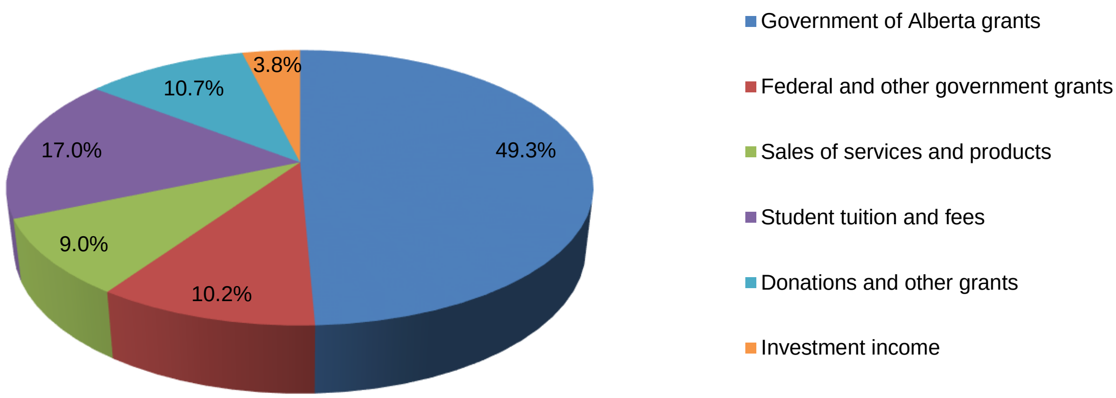
# Financial Results

For the year ended March 31, 2015, the University experienced an excess of revenues over expenses of $53.9 million. This surplus has decreased from the $65.7 million achieved in 2014 mainly due to increased spending on strategic research, academic and support initiatives combined with inflationary pressures exceeding operating funding increases.

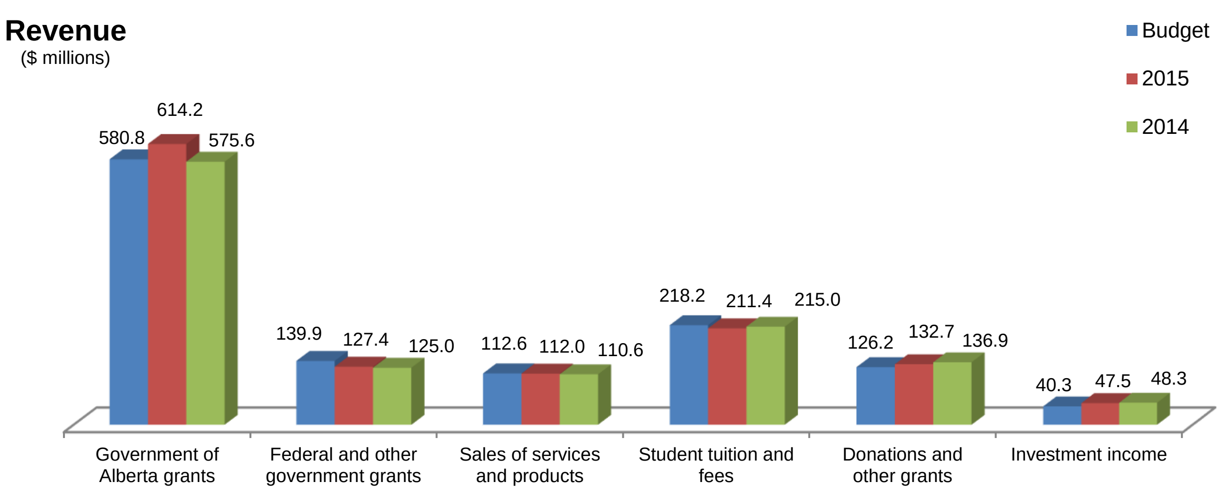
The $53.9 million in excess revenues over expenses combined with $128.7 million in endowment additions and $9.6 million increase in remeasurement gains from unrealized income on working capital investments resulted in total net assets of $1,396.7 million for the year ended March 31, 2015. This represents an increase of $192.2 million from March 31, 2014.

## Revenue

Revenue from the Government of Alberta represents the University's single largest source of income, at 49.3% of total University revenue in 2015, and plays a key role in the ability to fund University activities.




Total revenues for the year ended March 31, 2015, were $1,245.2 million, an increase of $33.8 million (2.8%) over the prior year and $27.2 million (2.2%) over budget. Major components of revenue are as follows:



### Government of Alberta grants

Government of Alberta grant revenue of $614.2 million increased by $38.6 million over the prior year and was $33.4 million higher than budgeted. Key factors contributing to this increase in revenue relate to $23.0 million in additional revenues recognized from previously deferred research and special purpose funding, $6.4 million in increased revenue recognized from capital grants that coincides with the use of government funded assets, and a $3.8 million increase in one time operating funding from the Government of Alberta.

### Federal and other government grants

Although grant revenue from federal and other government sources of $127.4 million was $12.5 million less than budgeted, revenues increased over the prior year by $2.4 million primarily due to $2.5 million increased funding relating to the Nursing program in Qatar and $2.0 million increase in recognition of capital grant revenues, partially offset by less than expected revenues recognized from previously deferred research and special purpose grants. The budgetary shortfall is mainly the result of revenue timing differences between receiving grant contributions and when the grants are recognized into revenue over the period of conducting the related research.

### Sales of services and products

Through the use of creative and entrepreneurial options, the University continues to develop alternative sources of revenue to fund operations and strategic initiatives. Sales of services and products revenue of $112.0 million was $1.4 million higher than the prior year and consistent with budgeted expectations.

### Student tuition and fees

Student tuition and fees represent another important component of the University's funding of educational goals. For the year ended March 31, 2015, student tuition and fees of $211.4 million were $6.8 million below budget and $3.6 million less than the prior year due to a 3.9% decrease in enrolment partially offset by increased summer camp program fees. With tuition representing only a portion of the cost of educating students and with inflationary pressures exceeding operating grant funding growth, difficult but strategic enrolment decisions were made to ensure quality of education and student experience were maintained.

### Donations and other grants

While donation and other grant revenues of $132.7 million were $4.2 million less than the prior year, donation and other grant revenues exceeded budget targets by $6.5 million. The drop in revenues compared to the prior year relate to less than expected revenues recognized from previously deferred donations and coincides with an increase in philanthropic activity being directed by donors towards university endowments resulting in a $52.8 million increase in endowment donations compared to the prior year. In addition, donations are recorded when received and do not contain donation pledges.

### Investment income – Including Investment loss in government business enterprises

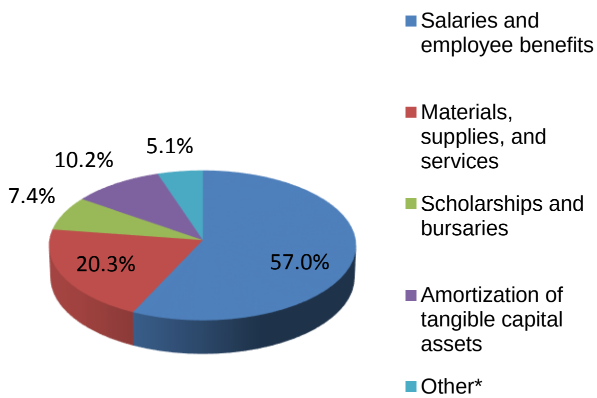
Investment income of $47.5 million including investment loss from government business enterprises ("GBE's") remained relatively unchanged from the prior year and exceeded budgeted amounts by $7.2 million. Within these revenues, working capital investment income exceeded prior year amounts by $5.2 million and budgeted amounts by $13.7 million and were partially offset by less than expected revenues recognized relating to endowment spend activities. The combined increases in working capital and endowment investment income were offset by a $5.6 million decrease in revenues from university GBE's. During the 2014 fiscal year, University Technologies Group experienced a one-time gain relating to the commercialization of research intellectual property. Current year GBE losses are mainly driven by continued development costs incurred by West Campus Development Trust which will be recovered from revenues once west campus lands have been developed and commercialized for use.

## Expense

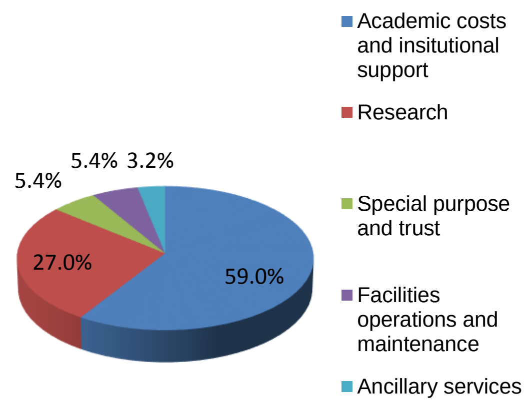
Salaries and benefits are the largest expenditure component at the University, representing 57.0% of the University's expenses. Compensation expense continues to be a challenge when making budgeting decisions, especially during times where increases in operating grants do not adequately cover the increase in salaries that are often governed by union and faculty agreements.

Academic costs and institutional support represents the single largest function at the University, with this function representing 59.0% of the University's expenses. This includes instruction, non-research academic and administrative support activities, effectively representing the operating activities of the University.

**Expense by Object**



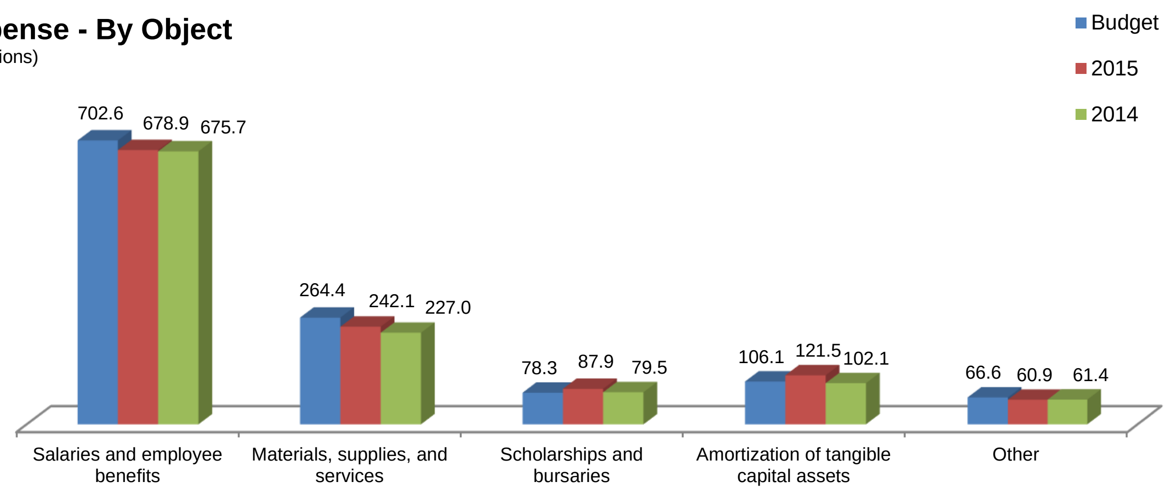

**Expense by Function**




*Other expenses include: Utilities; Maintenance and repairs; and Cost of goods sold.

For the year ended March 31, 2015, the University recorded $1,191.3 million in expenses representing an increase of $45.6 million (4.0%) over the prior year and $26.7 million (2.2%) less than budget.

**Expense - By Object**
($ millions)



## Salaries and employee benefits

Of the total compensation expense of $678.9 million, salaries comprise $576.6 million and employee benefits comprise $102.3 million. Salaries and employee benefits have increased by $3.2 million over the prior year but are $23.7 million less than budget. The net variance from the prior year is made up of increased salaries expense of $17.9 million related to salary increases due to merit and negotiated union agreement increases. Partially offsetting this variance was a decrease in employee benefits expense of $14.7 million, related primarily to reduced pension and WCB expenses. Salaries and employee benefits were lower than expected due to operating vacancies for positions in the faculties of Medicine, Arts, Engineering, Science, Haskayne and Education, as well as in Facilities, IT, and Development areas.

## Materials, supplies and services

Materials, supplies and services of $242.1 million represents the second largest expense component of the University with current year costs being $15.1 million higher than the prior year and $22.3 million less than budget. The increase over the prior year is a result of increased research activities in support of the University's *Eyes High* goals. The budget variance is primarily due to $31.2 million of contingency funds budgeted in materials supplies and services that remained unspent at year-end and partially offset by higher materials, supplies and services spending as well as inflationary pressures.

## Scholarships and bursaries

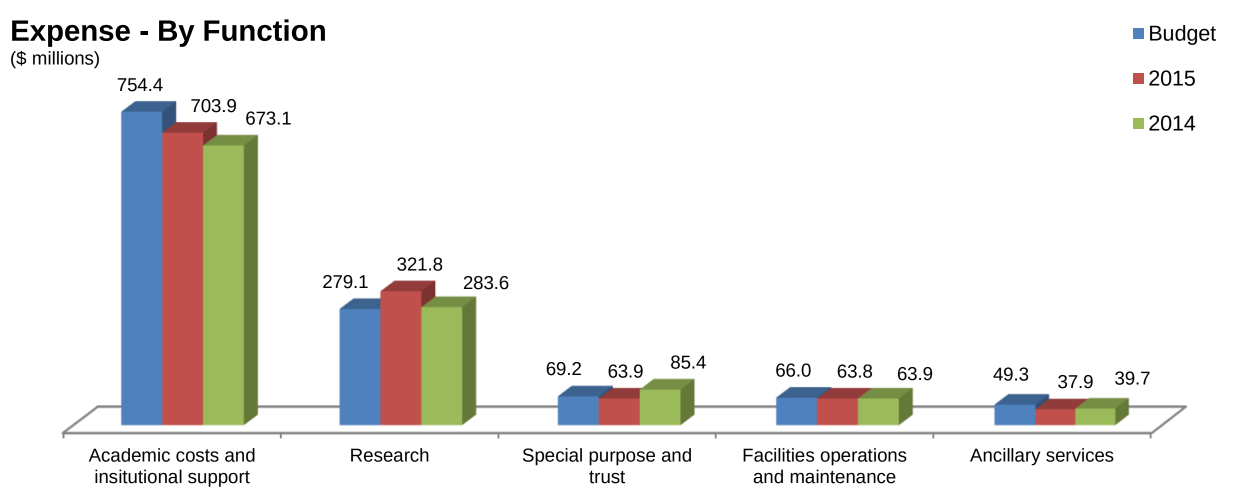
Scholarships and bursaries of $87.9 million experienced an $8.4 million increase over 2014 and a $9.6 million increase over budget. These higher expenses are in line with University goals for attracting and supporting students, especially in Research.

## Amortization of tangible capital assets

Amortization of tangible capital assets expense of $121.5 million increased by $19.4 million from the prior year and is $15.4 million over budget. This increase relates primarily to bringing additional assets into service in 2015 which are now subject to amortization. In addition, the University recorded a write-down of $1.8 million to amortization related to residence buildings which are being replaced by the construction of new residences.

## Other

Other expenses totaling $60.9 million were relatively consistent with the prior year amounts but less than expected due mainly to $4.3 million in lower than budgeted utilities costs.



### Academic costs and institutional support

While Academic costs and institutional support expenses of $703.9 million have increased $30.8 million over the prior year primarily due to inflationary pressures and the function's proportionate share of increased materials and supplies costs, academic costs and institutional support expenses are $50.5 million less than budget. The budgetary savings are primarily due to $31.2 million in unused budgeted contingencies and the proportionate share of salaries and benefits budget savings due to vacant positions that were not filled for portions of the year.

### Research; Special purpose and trust

Research costs of $321.8 million were $38.2 million higher than prior year and $42.7 million higher than budget. At the same time, special purpose and trust costs of $63.9 million were $21.5 million below prior year amounts and $5.3 million less than budget. The University has strategically focused directing resources and activities towards research initiatives in 2015 in support of *Eyes High* goals for increasing research across many faculties of the University, explaining the offsetting variances in these two functions.

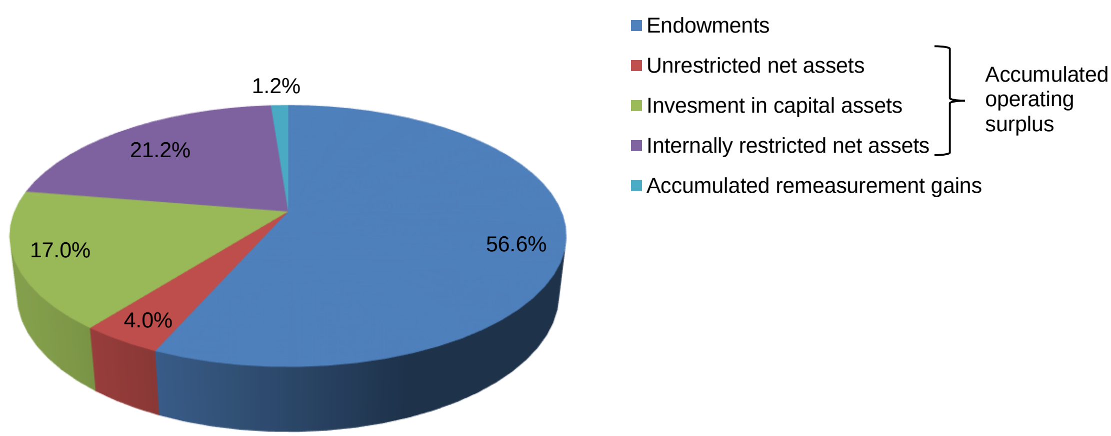
### Facilities operations and maintenance; Ancillary services

Both facilities operations and maintenance and ancillary expenditures, of $63.8 million and $38.0 million respectively, remained comparable to the prior year with continued cost savings compared to budget.

## Net Assets and Liquidity

**Net Assets**

The University's net asset balance is an important indicator of financial health for the University. Through prudent financial planning and decision making combined with increased endowment contributions from donors and endowment investment gains, the University's net assets of $1,396.7 million at March 31, 2015 increased by $192.2 million compared to the prior year.




A significant portion of this $192.2 million increase in net assets is due to an increase in Endowments of $128.7 million. Endowment funds are those for which the donor has requested the fund principal be maintained in perpetuity. The $128.7 million increase in endowed net assets is due to $62.0 million in donations and contributions and $66.7 million in realized and unrealized investment gains capitalized to endowments to inflation protect endowment balances.

The remaining increase to net assets of $63.5 million is due to $53.9 million in surplus revenues over expenses and $9.6 million in increased remeasurement gains from unrealized income on working capital investments. As shown in the table below, of the $53.9 million surplus, $17.7 million was spent on net purchases of capital assets, $9.0 million was spent on debt repayments and a net of $44.0 million was internally restricted for future internally funded research, capital and other project activities. The shortfall of $16.8 million after these expenditures and restrictions has been deducted from the University's unrestricted net assets resulting in an ending unrestricted net asset balance of $56.0 million at March 31, 2015.

| **Accumulated Operating Surplus** ($ thousands) | Unrestricted Net Assets | Investment in Capital Assets | Internally Restricted Net Assets | Accumulated Operating Surplus |
|---|---|---|---|---|
| Balance at March 31, 2014 | $ 72,832 | $ 210,407 | $ 252,793 | $ 536,032 |
| Excess revenue over expense | 53,912 | - | - | 53,912 |
| Net acquisition of capital assets | (17,747) | 17,747 | - | - |
| Debt repayment | (9,030) | 9,030 | - | - |
| Net internal restrictions | (43,993) | - | 43,993 | - |
| Balance at March 31, 2015 | $ 55,974 | $ 237,184 | $ 296,786 | $ 589,944 |

## Liquidity

The University's liquidity needs are met primarily through operating cash flow and with financing for significant capital expansion being obtained, when required and subject to governmental approval. The Net Financial Position indicator is used by management to monitor the University's ability to use its financial assets to settle all financial liabilities. The University has a sufficiently positive net financial position, demonstrating financial strength and commitment to managing our financial commitments.

| **Net Financial Position** ($ thousands) | 2015 |
|---|---|
| FINANCIAL ASSETS | |
| Cash and cash equivalents | $ 199,870 |
| Portfolio investments (excluding endowment investments*) | 940,571 |
| Accounts receivable | 65,355 |
| Inventory for resale | 5,842 |
| Total Financial Assets | $ 1,211,638 |
| FINANCIAL LIABILITIES | |
| Accounts payable and accrued liabilities | $ 156,752 |
| Employee future benefit liabilities | 132,572 |
| Debt | 277,166 |
| Deferred revenue (excluding amounts spent on capital**) | 537,845 |
| Total Financial Liabilities | $ 1,104,335 |
| Net Financial Position | $ 107,303 |

*Endowment investments support the endowed net asset balance required to be maintained in perpetuity. As a result, endowment investments are not available to settle financial liabilities and are removed from total financial assets.
**Deferred revenue balances relating to amounts already spent on capital assets are extinguished and recognized into revenue over the use of the related capital asset and are not extinguished through the settlement or use of a financial assets. As a result, deferred revenue balances pertaining to amounts already spent on capital assets, but have yet to be recognized as revenue, are removed from calculating total financial liabilities.

The University also analyzes current assets and current liabilities to ensure the University is well positioned to meet short term commitments. The University's consolidated financial statements are prepared in accordance with PSAS, which does not segregate current assets and current liabilities in the Consolidated Statement of Financial Position. When calculating the University's current ratio at March 31, 2015, the University has sufficient short term assets to meet short term liabilities. A component of short term liabilities relates to deferred revenues that on an annual basis are funded by restricted contribution inflows equal to the related short term liability balance. When excluding the deferred revenue component, the University's adjusted current ratio at March 31, 2015 is 3.38, highlighting the University's strong short term liquidity position.

## Capital Expansion and Renewal

Continuation of capital expansion and renewal projects remains a critical priority for the University, contributing not only to the student learning experience and the quality of research activity, but also positively to the Calgary economy. In 2015, the University expended $208.3 million (2014 - $159.5 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 through construction of new buildings as well as redevelopment, renovation, and numerous instructional facility upgrade projects.

The following represents progress on the top six major construction projects on campus:

| **Major Capital Project Costs** ($ thousands) | 2015 | Project to Date | Total Budget |
|---|---|---|---|
| Schulich School of Engineering Expansion | $ 34,812 | $ 56,292 | $ 164,775 |
| Crowsnest Hall Graduate Residence | 36,063 | 43,170 | 50,400 |
| The Taylor Institute for Teaching and Learning | 16,075 | 20,661 | 40,000 |
| Aurora Hall undergraduate Residence | 24,241 | 28,797 | 37,100 |
| Mobility and Joint Health | 5,588 | 5,639 | 13,447 |
| Education Tower Restack Plan | 6,104 | 6,520 | 9,710 |

*Schulich School of Engineering Expansion and Renovation (SSE)* – During 2013-14, construction began on this $164.8 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 of the existing building footprint. The building expansion includes high intensity research labs and support spaces, undergraduate engineering teaching labs, group workrooms, low intensity research facilities, and classroom and theatre spaces.

*Aurora Hall Undergraduate Residence; Crowsnest Hall Graduate Residence* – As part of the University's goal to increase on-campus student accommodation to 15.0% of undergraduate full-load enrolment by 2022, construction of the Aurora Hall Undergraduate Residence is targeted for completion in the summer of 2015. Additionally, Crowsnest Hall Graduate Residence will be a 390 bed facility for graduate students while Aurora Hall Undergraduate Residence will be a 268 bed upper-year undergraduate residential building.

*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. The Taylor Institute for Teaching and Learning will be a leading-edge facility that will become a signature building on the University main campus. Conceived with the specific objective of maximizing natural light and weaving the most advanced learning technology throughout the space, the new facility will serve as an ideal platform to promote advances in teaching and learning. The structure will break free of the classroom mold by incorporating the latest advances in learning spaces. 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 winter of 2016.

*Mobility and Joint Health* – This project entails the renovation of approximately 400 square metres of existing space to create a clinical state of the art diagnostic imaging facility dedicated to advancing bone and joint research. Planned completion of this project is in the fall of 2015.

*Education Tower Restack Plan* – Given the age and condition of the University's Education Tower, extensive renovations are planned for the majority of the floors of this fourteen floor structure to create collaborative academic and research environments.

# 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. The University has an outstanding deferred maintenance balance of nearly $481.0 million (2014 - $450.0 million). Infrastructure Maintenance Program (IMP) funding from the province remained equal to the prior year at $9.9 million in both fiscal 2014 and fiscal 2015. While the University recognizes that there are budgetary constraints facing the Government of Alberta, lack of increases to IMP funding significantly impacts the University's ability to proactively manage and address this deferred maintenance risk.

## 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, 2015 was $1,129.9 million (2014 - $1,056.9 million) of which the University's portion is $147.3 million (2014 - $132.6 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 are unable to isolate their portion of the total unfunded deficiency at December 31, 2014 of $803.3 million (2013 - $1,254.7 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 2015-16, it is presenting deficit forecasts for 2016-17 and 2017-18. The University is facing a number of risk factors, most notably funding uncertainty related to provincial operating funding. Without increases in provincial funding to offset inflationary costs, and combined with legislatively mandated ceilings on tuition increases, the University will continue to explore and implement process efficiencies and revenue generating opportunities. The University will continue to work in partnership with the government, 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 strategic risk for the University of Calgary.