UNIVERSITY OF ALBERTA

Financial Statement Discussion and Analysis

For the Year Ended March 31, 2019

The consolidated financial statement discussion and analysis should be read in conjunction with the University of Alberta audited financial statements. The university's financial statements have been prepared in accordance with Canadian Public Sector Accounting Standards. For more in-depth discussion and analysis of the university's goals and objectives please refer to the following documents:
For the Public Good, Comprehensive Institutional Plan, Investment Reports.
https://www.ualberta.ca/reporting

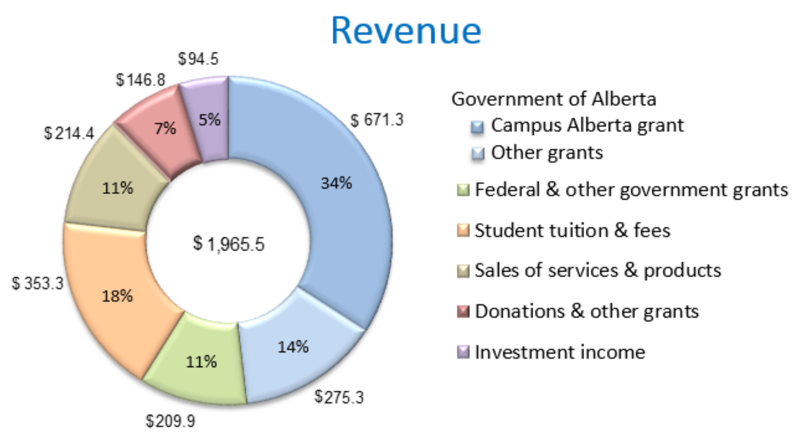
The consolidated financial statement discussion and analysis provides an overview of the university's:

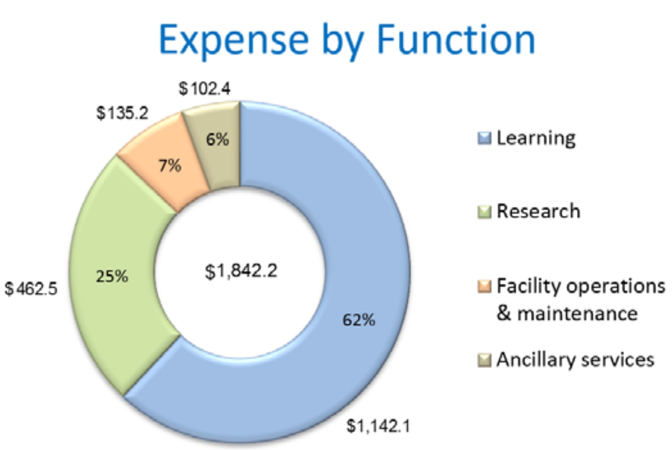
- Summary of Financial Results
- Revenue and Expense
- Capital Acquisitions
- Net Assets and Net Debt
- Areas of Significant Financial Risk

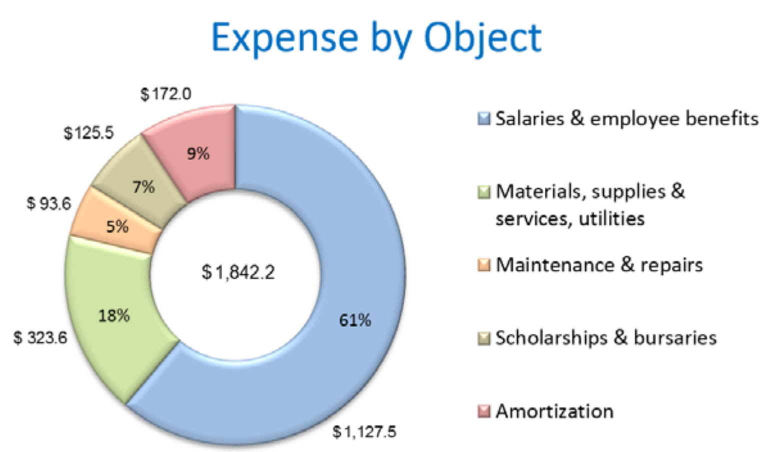
Summary of Financial Results

The university ended the year with an annual surplus of $198.8 million. Of this amount $75.5 million are donations directed to endowments and endowment capitalized investment income and therefore are not available for spending. The annual operating surplus of $123.3 million; 6.3% of total revenue (budget: $14.4; 0.7% of total revenue) was primarily used for capital and investment acquisitions and debt repayment. Capital acquisition expenditures include library resources, scientific equipment and computer hardware/software.

Net assets of $2,179.5 million increased from the prior year (2018: $2,005.8). The increase is mainly due to an increase in endowments and the annual operating surplus.

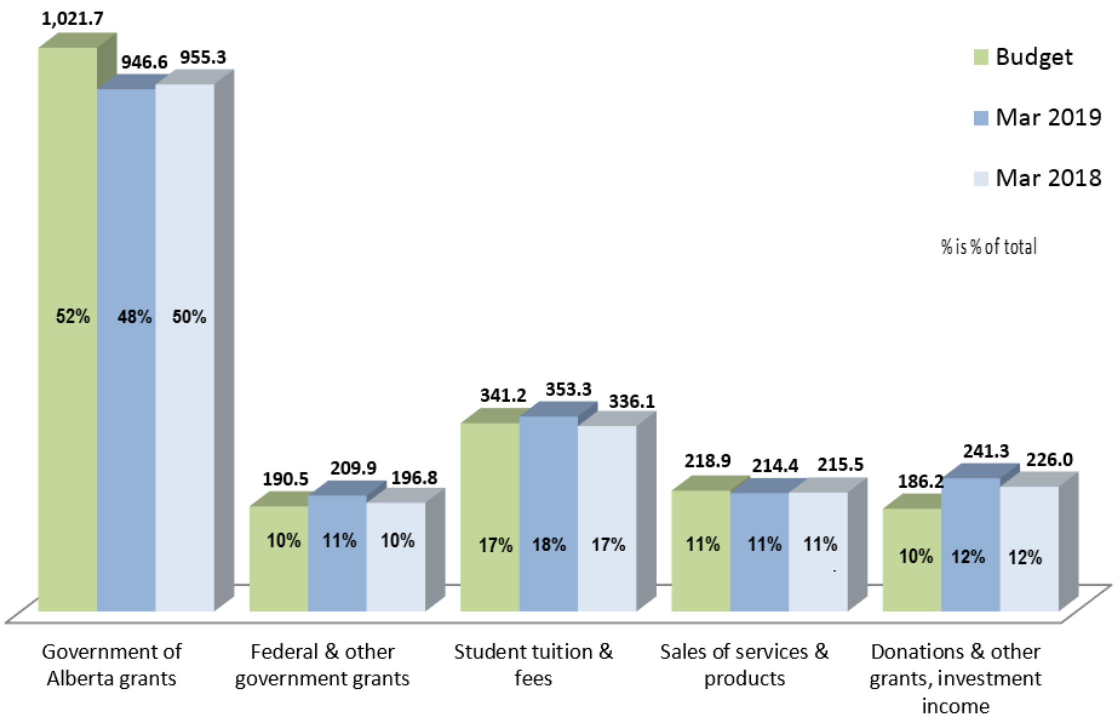






Revenue

Total revenue for the year was $1,965.5 million, an increase of $35.8 million over the prior year and $7.0 million (0.4%) more than budget.



Government of Alberta grants (GoA) represent the single largest source of funding for university activities at 48% of total revenue. The GoA increased the Campus Alberta grant (base operating grant) by 2%. Grants are less than budget mainly due to lower research grants and lower than budgeted grant funding for the Academic Medicine and Health Services Program (AMHSP) (offset in donations and other grants).

Federal and other government grants primarily support the university's research activities. Grants are more than budget due to higher than budgeted grant funding from the Federal Government of Canada.

Student tuition and fees includes instructional fees, market modifiers, program differential fees, international student fees, and mandatory non-instructional fees. The GoA has frozen domestic tuition fees for the past three fiscal years and in October 2018 announced that the tuition freeze will be extended through the 2019-20 academic year. Student tuition and fees are more than budget due to higher enrollment of international students.

Sales of services and products revenues are generated by ancillary services and faculties and administrative units to both individuals and external organizations. Ancillary services generated sales of $91.5 million, while other units generated sales of $122.8 million. Sales revenue is comparable to budget.

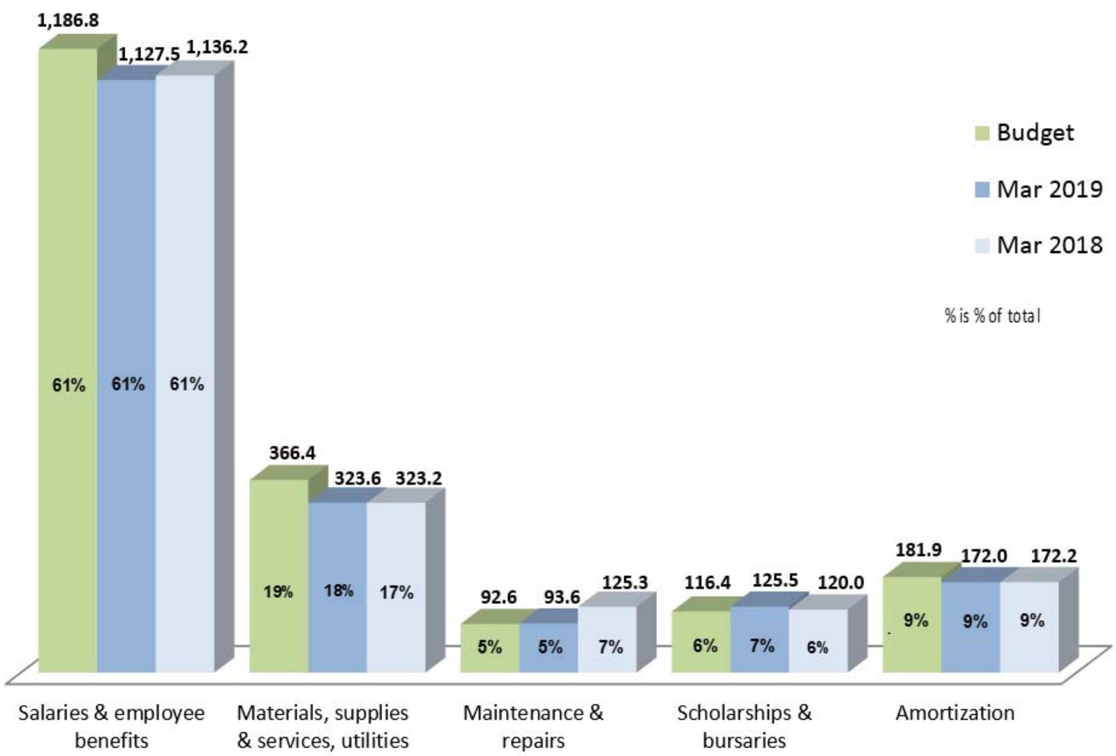
Donations and other grants support many university activities. Donations and other grants are more than budget mainly due to the AMHSP grant funding (offset in GoA) and more than budgeted research grant funding.

Investment income is $23.5 million more than budget mainly due to the realization of capital gains. Investments fall into two categories, the University Endowment Pool (UEP) and the Non-Endowed Investment Pool (NEIP). The UEP had a return of 5.9% (2018: 8.0% return) and represents the majority of the university's long-term investment strategy. The NEIP investments which are allocated to the short-, mid- and long-term investment strategies had a return of 3.5% (2018: 2.9% return).

Expense

Total expense for the year was $1,842.2 million, a decrease of $34.7 million over the prior year and $101.9 million (5.2%) less than budget. Salaries and employee benefits are the single largest expense representing 61% of total expense.

Expense by Object



Salaries and employee benefits are less than budget mainly in the research fund due to lower spending on salaries for research projects along with lower use of temporary staffing.

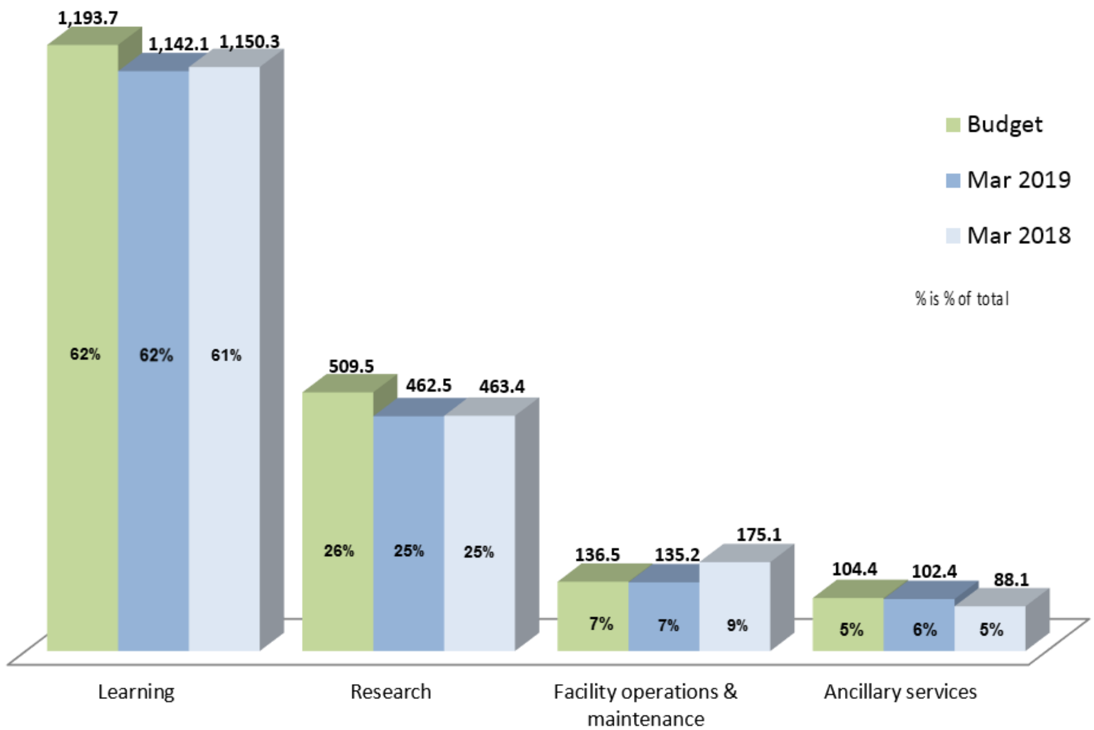
Materials, supplies and services, utilities are less than budget mainly due to lower expenditures in the research fund for general services for research projects. Utilities is lower than budget due to lower than budgeted utility rates.

Maintenance and repairs is comparable to budget.

Scholarships and bursaries are more than budget due to a higher number of graduate awards and higher than budgeted endowed scholarships.

Amortization is less than budgeted due to Strategic Investment Fund (SIF) projects coming into service later than planned.

Expense by Function



Learning effectively represents the operating activities of the university. A significant component of this category is salary and employee benefit costs. Learning also includes restricted grants and donations that support undergraduate student scholarships, student bursaries and the Academic Medicine and Health Services Program (AMHSP). This expense is less than budget mainly due to lower spending on salaries and materials and services.

Research activities expenses are funded by restricted grants and donations as well as internal funds designated for research related spending. This expense is less than budget due to lower spending on salaries and general services for research projects.

Facility operations and maintenance represents the cost of maintaining university facilities and grounds. This expense is comparable to budget.

Ancillary services include the university bookstore, parking services, utilities and student residences. Ancillary services expenses are comparable to budget.

Capital Acquisitions

The university expended $124.6 million (2018: $197.9) on construction and other tangible capital asset acquisitions.

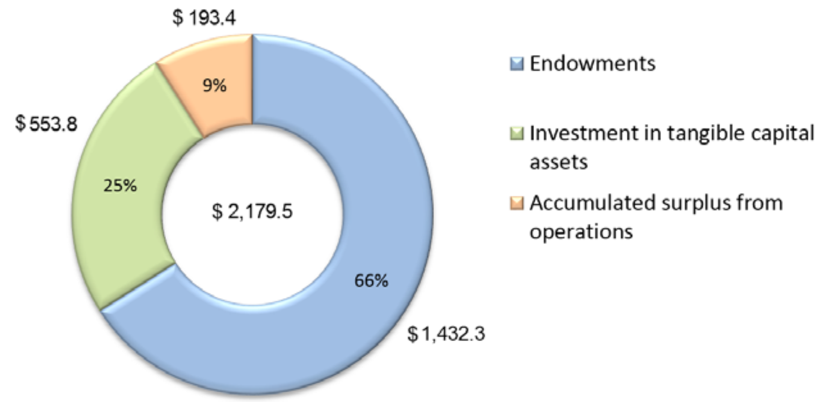
The most significant construction and capital asset acquisitions in 2019 are:
- Two new residence construction projects - Nîpisîy House and Thelma Chalifoux Hall.
- Dentistry and Pharmacy Renewal and Repurpose - a multi-year project to renovate the Dentistry Pharmacy building.
- University of Alberta Botanic Garden – the new Aga Khan Garden and infrastructure upgrades.
- Various Strategic Investment Fund projects which were funded by a combination of GoA grants and university resources.

(in millions of dollars)

Net Assets and Net Debt

Net assets

The net asset balance is an important indicator of financial health for the university. The net assets measure provides the economic position of the university from all years of operations. The university's net assets include endowments of $1,432.3 million. Endowments represent contributions from donors that are required to be maintained in perpetuity, as well as capitalized investment income that is also required to be maintained in perpetuity to protect the economic value of the endowment. Endowments are not available for spending. Of the remaining $747.2 million in net assets, $553.8 million represents funds invested in tangible capital assets.



	Unrestricted	Internally restricted	Investment in tangible capital assets	Endowments	Total
Net assets, beginning of year	$ 74.2	$ -	$ 552.1	$ 1,379.5	$ 2,005.8
Annual operating surplus	123.3	-	-	-	123.3
Endowments	(0.9)	-	-	76.4	75.5
Tangible capital assets	(1.7)	-	1.7	-	-
Transfer to internally restricted	(55.1)	55.1	-	-	-
Change in accumulated remeasurement gains	(1.5)	-	-	(23.6)	(25.1)
Increase	64.1	55.1	1.7	52.8	173.7
Net assets, end of year	**$ 138.3**	**$ 55.1**	**$ 553.8**	**$ 1,432.3**	**$ 2,179.5**

The increase in accumulated surplus from operations is mainly due to the annual operating surplus ($123.3). The university also transferred $0.9 million from accumulated surplus to endowments. The university created an internally restricted investment income reserve in the current year ($55.1). The purpose of the reserve is to create a buffer for risk management purposes; that is, to ensure that future financial obligations can be fulfilled in the event of significant investment losses. The reserve target is 17% of the underlying obligations (investment cost), currently $96 million, which allows for fluctuations in capital and equity markets to the degree experienced during the financial crisis in 2008-09. Once the reserve target is met, allocations will be made to a Strategic Initiatives Fund that will be used to support long-term institutional goals.

The increase in investment in tangible capital assets of $1.7 million consists of additions ($65.6) and debt repayments ($13.3), less new financing ($16.8) and amortization ($60.4). These additions include construction projects, equipment, furnishings, computer hardware/software and library resources.

The university's endowment spending policy provides for an annual spending allocation (2019: $49.0; 2018: $38.1) to support a variety of key initiatives in the areas of academic programs, chairs and professorships, scholarships, bursaries and research. The increase in endowments of $52.8 million is due to an increase in fair value ($15.7), new contributions ($36.2) and a transfer of miscellaneous sales revenue from unrestricted net assets ($0.9).

Net debt

The university's liquidity needs are met primarily through operating cash flows, working capital balances and capital expansion funding received through grants or long-term debt. Net financial assets (net debt) is a measure of an organization's ability to use its financial assets to cover liabilities and fund future operations.

The net debt (excluding portfolio investments restricted for endowments) indicates that the university has a $97.8 million deficiency (2018: $213.5). The deficiency can be attributed to employee future benefit liabilities (2019: $217.8; 2018: $237.8) which include the Universities Academic Pension Plan (UAPP) (2019: $116.4; 2018: $141.7) and other benefit plans such as supplementary retirement, long-term disability and early retirement (2019: $101.4; 2018: $96.1). Net debt has decreased mainly due to the annual surplus and a decrease in employee future benefit liabilities resulting primarily from strong investment returns within the pension plan.

Areas of Significant Financial Risk

Fiscal Uncertainty

The Campus Alberta grant is the primary source of funding for the university's day-to-day operating activities. Government support is under pressure given the province's fiscal outlook. Grants, tuition and other revenue generation initiatives are largely under government control, which puts significant pressure on university finances. The impact to university revenue of a 1% change to the Campus Alberta base operating grant is $6.7 million and a 1% change to domestic tuition is $2.0 million.

Unfunded Pension Liability

The university participates with other Alberta post-secondary institutions in the Universities Academic Pension Plan (UAPP) to provide pensions for the university's participating employees. The unfunded deficiency in the UAPP is currently being funded by a combination of employee and employer contributions and the Government of Alberta. The deficiency is required to be eliminated by 2043. At March 31, 2019, based on actuarial assumptions, the university has recorded a UAPP employee future benefit liability of approximately $116 million.

The impact to the university's share of the unfunded liability of a 1% increase in the inflation rate assumption would be an increase of approximately $76 million, a 1% increase in the salary escalation assumption would be an increase of approximately $15 million, while a decrease of 0.25% in the discount rate assumption would lead to an increase of approximately $38 million.

Deferred Maintenance

As the largest and oldest post-secondary institution in the province, the university's deferred maintenance obligations continue to increase. As of December 2018 the liability stood at $311 million and is estimated to increase to approximately $888 million over the next five years. The university continues to identify and address priority deferred maintenance issues through joint renewal and repurposing projects to maintain the functionality of our building inventory. We are grateful for the Government's continued support of the Infrastructure Maintenance Grant Program (2019: $34.9; 2018: $34.9) which assists in addressing the deferred maintenance priorities.