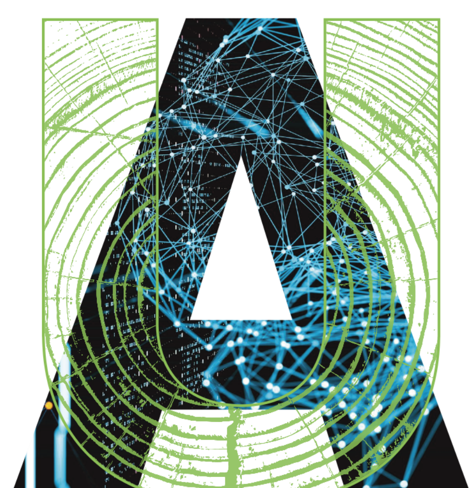
UNIVERSITY OF ALBERTA

Consolidated Financial Statements

Discussion & Analysis

For the year ended March 31, 2023



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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, Investment Reports, Annual Report, University of Alberta for Tomorrow.
https://www.ualberta.ca/reporting
https://www.ualberta.ca/uofa-tomorrow/index.html

Summary of Financial Results

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 Financial Assets/Net Debt
- Areas of Significant Financial Risk

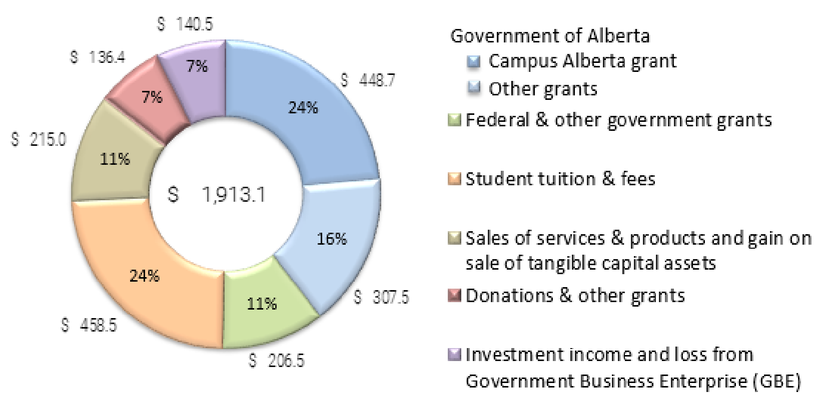
Note: March 31, 2022 results have been restated to reflect the impact of the adoption of the Asset Retirement Obligations (ARO) standard.

The university ended the year with an annual consolidated surplus of $72.3 million. Of this amount $37.4 million are donations directed to endowments and endowment capitalized investment income and therefore are not available for spending. The annual operating surplus was $34.9 million, which is 1.8% of total revenue (budgeted annual operating surplus: $0.4 million; 0.0% of total revenue). The decrease of $90.9 million from the prior year annual operating surplus of $125.8 million (restated) was primarily due to the gain on sale of tangible capital assets ($34.9, primarily sale of Newton Place) in the prior year, the recovery of the temporary endowment encroachment ($31.2) in the prior year and a current year loss on the sale of tangible capital assets ($9.5 primarily the sale of the Soaring Estates land).

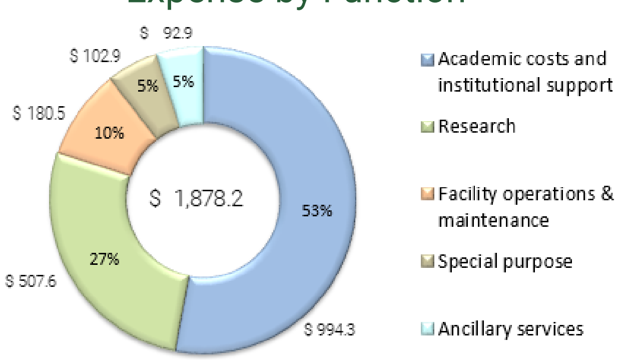
Net assets of $2,594.2 million increased from the prior year (2022: $2,483.2 restated). The increase is mainly due to an increase in the fair value of portfolio investments ($38.7) along with the annual surplus ($72.3).

The following figures provide an overview of the university revenue, expense by object, and expense by function.

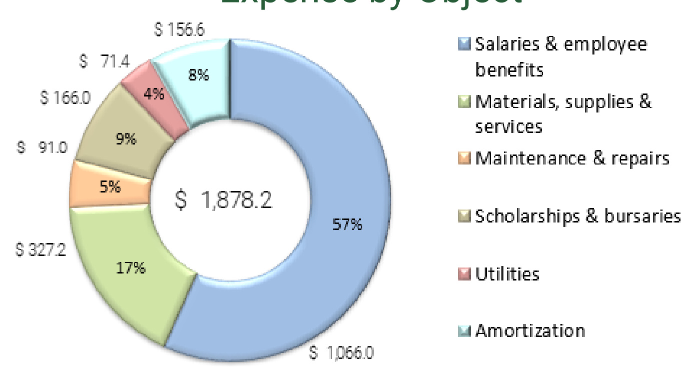
Revenue



Expense by Function



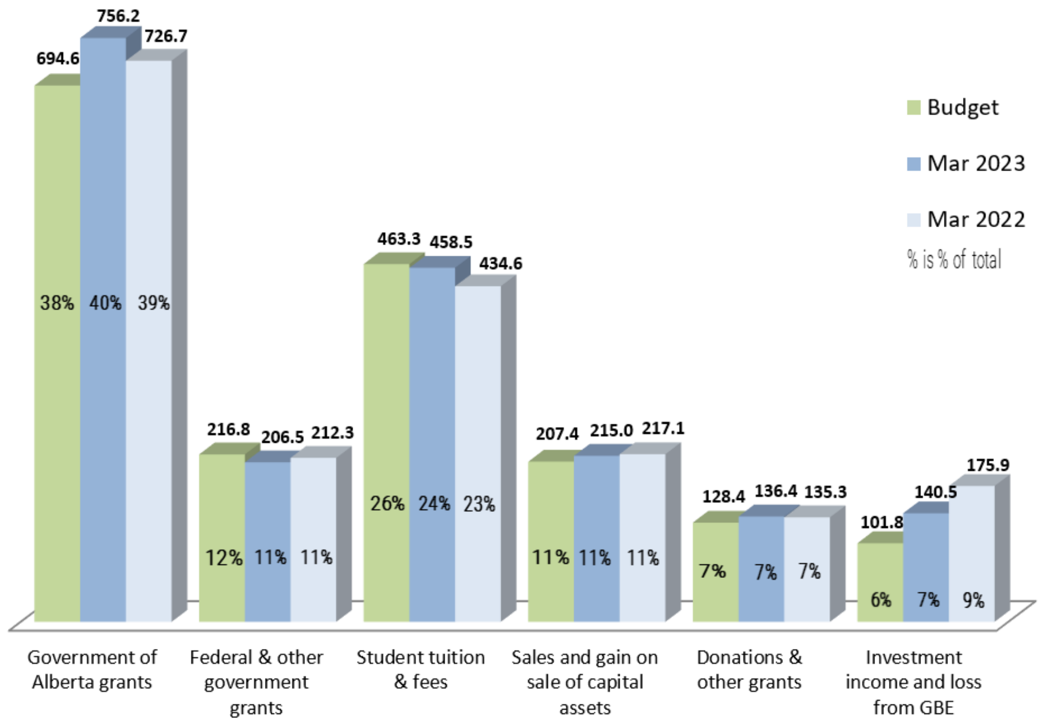
Expense by Object



Revenue

Total revenue for the year was $1,913.1 million, an increase of $11.1 million (0.6%) over the prior year and $100.8 million (5.6%) more than budget.

Figure 1. University of Alberta Revenue



Government of Alberta Grants

Government of Alberta (GoA) grants represent the single largest source of funding for university activities at 40% of total revenue. GoA grant revenue of $756.2 million was $29.5 million higher than prior year and $61.6 million higher than budget. The increase over prior year is mainly due to large new research grants from Alberta Technology and Innovation (mainly Covid-19 countermeasures grant) and a targeted enrolment expansion grant ($8.3 million). This was partially offset by a reduction in the Campus Alberta operating grant ($52.1 million). The increase compared to budget is mainly due to the aforementioned Covid-19 research grant and the targeted enrolment expansion grant.

Federal and Other Government Grants

Federal and other government grants primarily support the university's research activities. Federal and other government grants revenue of $206.5 million was $5.8 million lower than prior year and $10.3 million lower than budget. The decrease over prior year cannot be attributed to any one individual item. The decrease compared to budget is due to lower research funding from Canada Research Chair grants (a Government of Canada agency).

Student Tuition and Fees

Student tuition and fees includes instructional fees, market modifiers, program differential fees, international student fees, and mandatory non-instructional fees. Student tuition and other fees revenue of $458.5 million was $23.9 million higher than prior year but $4.8 million lower than budget. The increase over prior year was mainly due to an increase of $16.9 million in the international program-based fee model and $7.8 million in domestic and international tuition (7.0% domestic, 2% international guaranteed; and 4.0% international (fourth year)). The decrease compared to budget is mainly due to lower than planned domestic and international student enrolment of about 700 FLE (fulltime learning equivalent) students.

Sales of Services and Products / Gain on Sale of Tangible Capital Assets

Sales of services and products revenues are generated by ancillary services and faculties and administrative units to both individuals and external organizations to support university activities. Sales of services and products revenue of $215.0 million was $2.1 million lower than prior year and $7.6 million higher than budget. The decrease over prior year was mainly due to the gain on the sale of tangible capital assets in the prior year ($34.9) offset by higher ancillary revenues for residences and parking services due to a return to normal activities on campus ($32.8). The increase compared to the budget was mainly due to increased activity in non-sponsored research.

Donations and Other Grants

Donations and other grants support many university activities. Donations and other grants revenue of $136.4 million was $1.1 million higher than prior year and $8.0 million higher than budget. The increase over prior year was mainly due to a one time bequest of $8.3 million offset by lower donations for research activity. The increase compared to budget is mainly due to the one time bequest of $8.3 million which was not budgeted for.

Investment Income and Loss from Government Business Enterprises (GBE)

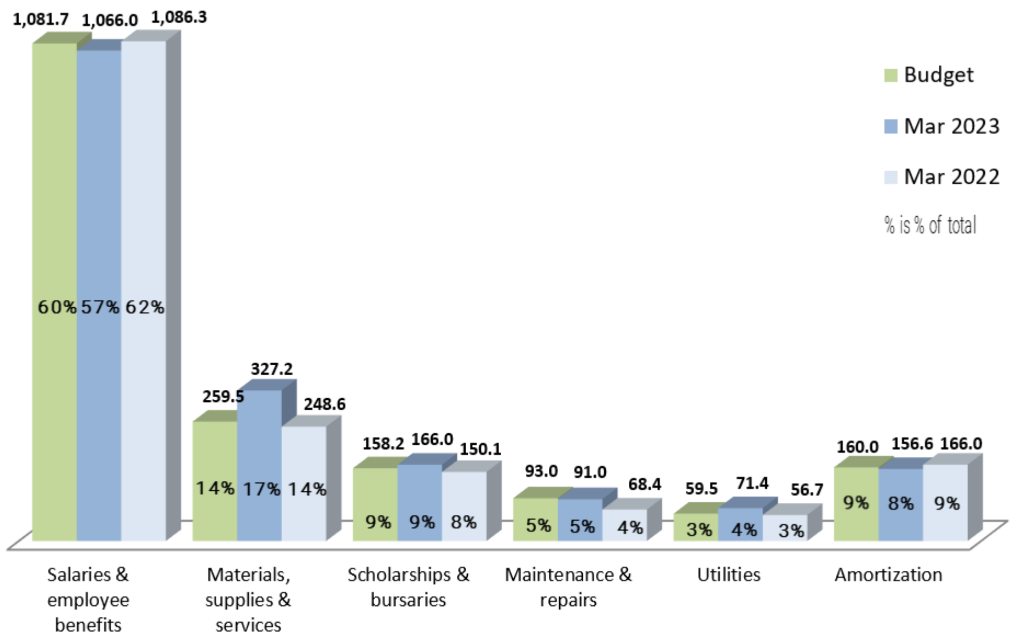
Investment income supports many university activities, both operating activities and a reserve for strategic and other initiatives. Investment income revenue, including the loss from GBE, of $140.5 million was $35.4 million lower than prior year and $38.7 million higher than budget. The decrease over prior year was mainly due to the recovery of the temporary endowment encroachment in the prior year ($31.2). The increase to budget was due to higher realized gains on disposal of investments and higher than budgeted interest rate return on shorter term investments. Investments fall into two categories, the University Endowment Pool (UEP) and the Non-Endowed Investment Pool (NEIP). The UEP had a return of 6.6% (2022: 9.5%) and represents the majority of the university's long-term investment strategy. The NEIP investments which are allocated to short-term, mid-term and long-term investment strategies had a return of 3.2% (2022: 4.2%). The return rates reflect both realized and unrealized gains in the investment portfolios. In 2015 the university established a wholly owned government business enterprise, University of Alberta Properties Trust Inc. to act as trustee for the University of Alberta Properties Trust. During the year, the trust recorded a loss of $0.5 million.

Expense

Total expense for the year was $1,878.2 million, an increase of $102.1 million over the prior year and $66.3 million (3.7%) more than budget. Salaries and employee benefits are the single largest expense representing 57% of total expense. Overall, the increase in expenses can be attributed to an increase in materials and supplies and maintenance as campus activity returned to near normal levels after the pandemic.

Expense by Object

Figure 2. University of Alberta Expense



Salaries and Employee Benefits

Salaries and employee benefits of $1,066.0 million was $20.3 million less than prior year and $15.7 million less than budget. The decrease over prior year is mainly due to lower UAPP pension expense as a result of the decrease in the UAPP deficiency due to higher interest rates for plan investments. The decrease compared to budget is mainly attributed to the same reason as the prior year decrease.

Materials, Supplies and Services

Materials, supplies and services of $327.2 million was $78.6 million more than prior year and $67.7 million more than budget. The increase over prior year is mainly due to loss on tangible capital assets, higher research project expenses and increased travel activity. The increase when compared to budget can also be attributed to the loss on tangible capital assets (not budgeted) and higher than budgeted research project expenses.

Scholarships and Bursaries

Scholarships and bursaries of $166.0 million was $15.9 million more than prior year and $7.8 million more than budget. The increase over prior year was due to an increase in undergraduate and awards funded from operations and an increase in undergraduate and graduate awards funded by endowments and restricted grants. The increase over budget is mainly due to higher graduate awards from restricted funding (grants and endowments). It should be noted that while other areas of the university continue to face significant funding pressures due to the decrease in the GOA base operating grant, scholarships to students continue to see increases due to the commitment made to students as part of overall tuition increases. This aligns with the University's goal to attract and support undergraduate and graduate students.

Maintenance and Repairs

Maintenance and repairs of $91.0 million was $22.6 million more than prior year but $2.0 million less than budget. The increase over prior year was mainly due to increased maintenance costs on a number of campus buildings (Health Sciences Library and Central Academic Building being the main ones), renovation costs for Enterprise Square and the demolition of buildings in the Michener Park site to get it ready for new development. Maintenance and repairs was less than budget, but there was no one individual significant item that can be attributable to the slight favorable variance.

Utilities

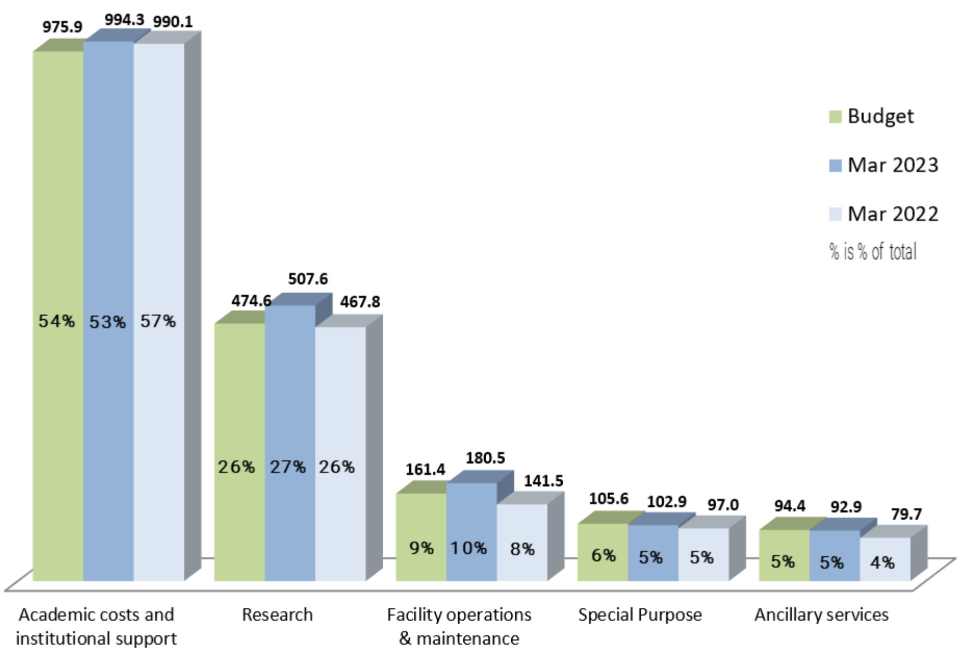
Utilities of $71.4 million was $14.7 million higher than prior year and $11.9 million higher than budget. The increase over prior year and the increase over budget was due to the higher than budgeted price for natural gas and for electricity.

Amortization

Amortization of $156.6 million was $9.4 million less than prior year and $3.4 million less than budget. The decrease over prior year was mainly due to the restatement of prior year amortization expense as a result of the implementation Asset Retirement Obligation along with lower amortization for equipment. The decrease over budget was mainly due to lower amortization expense for equipment and learning resources.

Expense by Function

Figure 3. University of Alberta Expense by Function



Academic Costs and Institutional Support

Academic costs and institutional support expenses effectively represent the operating activities of the university. A significant component of this category is salary and employee benefit costs. Expenses for this category of $994.3 million were $4.2 million more than prior year and $18.4 million more than budget. The variances are not significant and cannot be attributed to any particular event or expense.

Research

Research expenses are funded by restricted grants and donations along with internal funds designated for research related activities. Research expenses of $507.6 were $39.8 million more than prior year and $33.0

million more than budget. The increase over prior year and the increase over budget is mainly due to increased research activity on projects as activity returned to near pre-pandemic conditions.

Facility Operations and Maintenance

Facility operations and maintenance represents the cost of maintaining university facilities and grounds. Facility operations and maintenance expense of $180.5 million was $39.0 million more than prior year and $19.1 million more than budget. The increase over prior year is mainly due to higher utility costs and increased maintenance work on buildings as on campus activity returned. The increase over budget was mainly due to higher than budgeted natural gas and electricity rates.

Special Purpose

Special purpose expenses are for student awards and bursaries and other programs involving teaching and learning, and community service specifically funded by restricted grants and donations. Special purpose expense of $102.9 million was $5.9 million more than prior year and $2.7 million less than budget. The increase over prior year is due to an increase in scholarships and awards. No one individually significant item is accountable for the budget variance.

Ancillary Services

Ancillary services include the university bookstore, parking services, utilities and student residences. Ancillary services expense of $92.9 million was $13.2 million more than prior year and was $1.5 million less than budget. The increase over prior year is mainly due to higher cost of goods sold for electricity and natural gas used to produce steam and higher materials and supplies as activity returned to normal pre-pandemic conditions. No one individually significant item is accountable for the budget variance.

Capital Acquisitions

The university expended $148.6 million (2022: $197.1) on construction and other tangible capital asset acquisitions.

The most significant construction and capital asset acquisitions in 2023 continue to be:

- University Commons Renewal and Repurpose (formerly Dentistry and Pharmacy) - a multi-year project to renovate the building.
- Lister Centre renewal – a multi-year project to upgrade three residence towers in the Lister Centre complex.

The university also disposed the following asset (at fair value) during the course of the year:

- Soaring Estates land – a parcel of land along the river valley in Edmonton. This land was added to the inventory of the University of Alberta Properties Trust with the goal of further developing it.

Net Assets and Net Financial Assets / 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 $1,728.1 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 future economic value of the endowment. Endowments are not available for spending. Of the remaining $866.1 million in net assets, $460.2 million represents funds invested in tangible capital assets.

Figure 4. University of Alberta Net Assets

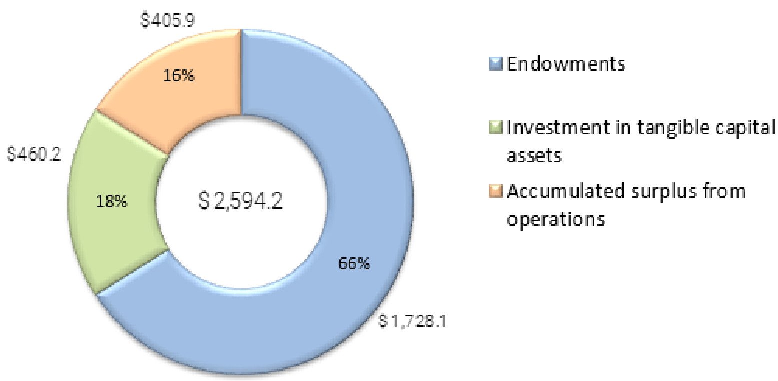


Table 1. University Net Assets	Unrestricted	Internally Restricted	Investment in Tangible Capital Assets	Endowments	Total
Net Assets, Beginning of Year	**$259.4**	**$103.0**	**$481.0**	**$1,639.8**	**$2,483.2**
Annual Operating Surplus	34.9	-	-	-	34.9
Transfer to Internally Restricted	(37.1)	37.1	-	-	-
Transfer from Internally Restricted	22.0	(22.0)			
Endowments Contributions and Capitalized Income	-	-	-	37.4	37.4
Transfer to Endowment	(8.8)	-	-	8.8	
Tangible Capital Assets	20.8	-	(20.8)	-	-
Change in Accumulated Remeasurement Gains	(3.4)	-	-	42.1	38.7
Increase (Decrease)	**28.4**	**15.1**	**(20.8)**	**88.3**	**111.0**
Net Assets, End of Year	**$287.8**	**$118.1**	**$460.2**	**$1,728.1**	**$2,594.2**

The increase in unrestricted net assets is mainly due to the annual operating surplus ($34.9) and funding for tangible capital assets ($20.8), partially offset by net transfers to the internally restricted reserve ($15.1), current year remeasurement loss on investments ($3.4), and a transfer capitalized to endowment principal ($8.8).

The university has an internally restricted reserve of $118.1 million, the current year transfer is $37.1 million. Of this amount $78.0 million is an investment income reserve while an additional $30.1 million has been appropriated to a Strategic Initiatives Fund, on top of the $10 million balance from last year for a total of $40.1 million, in support of various strategic initiatives in accordance with University Funds Investment Policy. During the fiscal year the university transferred $22.0 million from the Strategic Initiatives Fund for various Board approved one-time projects.

As per the University Funds Investment Policy, all realized Non-Endowed Investment Pool earnings not required for current budget purposes will be reinvested to build an investment income reserve. In the current year, this amounts to $37.1 million.

As at March 31, 2023 the market value of the Non-Endowed Investment Pool's yield and return seeking investments exceed their underlying obligations (cost) by $243 million or 25.5%. Of this amount, $118.1 million in realized gains have been set aside in internally restricted reserves which remain fully invested and at risk in the underlying investment strategies; the remainder represents unrealized investment gains. The purpose of the investment income reserve is to create a buffer for risk management purposes; that is, to ensure that all future financial obligations can be fulfilled in the event of unplanned liquidity requirements and significant investment losses occurring concurrently. The reserve target is 17% of the underlying obligations (investment cost), currently $162 million, which allows for fluctuations in capital and equity markets to the degree experienced during the financial crisis in 2008-09. Since the reserve target is currently being met, appropriations to a Strategic Initiatives Fund to support long-term institutional goals can be made. Details of the allocations can be seen in Table 2.

Table 2. University Investment Income and Strategic Reserves	**2023**	**2022**
Investment Income Reserve	$78.0	$71.0
Strategic Initiatives	40.1	32.0
Total Reserves, End of Year	**$118.1**	**$103.0**

The decrease in investment in tangible capital assets of $20.8 million consists of additions ($51.6) and debt repayments ($14.9), less financing allocation ($12.7), amortization ($68.6) and the change in asset retirement obligations ($6.0). The additions include construction projects, equipment, furnishings, computer hardware/software and library resources.

The university's endowment spending policy provides for an annual spending allocation (2023: $59.6; 2022: $56.9) 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 $88.3 million is due to an increase in fair value ($42.1), new contributions and capitalized investment income ($37.4), and a transfer of miscellaneous sales revenue from unrestricted net assets ($8.8). During the year the university's investment income earned from endowment investments was $98.7 million (2022 - $143.3). This is sufficient to fund the annual spending allocation of $59.6 million (2022 - $56.9) along with the investment management and administration fees of $19.5 million (2022 - $18.1). This left $19.6 million (2022 - $5.7) that was capitalized to endowment net assets as it was not required to meet the university's spending allocation obligations. In 2022, the remaining investment income from endowments covered the temporary endowment encroachment of $31.2, and the cumulative future commitment of $31.4 as provided per the University Endowment Pool (UEP) Spending policy.

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 financial debt position (excluding portfolio investments restricted for endowments) indicates that the university has a $81.6 million deficiency (2022: $121.8 deficiency). The deficiency can be attributed to the accumulated operating surplus $405.9 million (2022 - $362.4), offset by the incurrence of prepaid expenses $11.6 million (2022 - $12.1), tangible capital assets acquired by debt financing $311.5 million (2022 - $313.7) and asset retirement obligations of $164.4 million (2022 - $158.4). Net financial debt has decreased mainly due to the annual surplus partially offset by lower increase in unrealized gains on investments.

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 continues to decline. The final planned cut to the operating grant occurred in fiscal 2022-23 and was approximately $52 million. Grants, tuition and other revenue generation initiatives are largely under government control, which puts significant pressure on university finances. The results of the provincial election of May 2023 could also impact the direction that government funding takes in the future. The impact to university revenue of a 1% change to the Campus Alberta base operating grant is $4.5 million and a 1% change to domestic tuition is $2.2 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, 2023, based on actuarial assumptions, the university has recorded a UAPP employee future benefit liability of approximately $109 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 $23 million, a 1% increase in the salary escalation assumption would be an increase of approximately $8 million, while a decrease of 1% in the discount rate assumption would lead to an increase of approximately $56 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 March 2023, the estimated liability stood at $359 million and is estimated to increase to approximately $1.099 billion by 2028. Of the $359 million estimated liability, $164 million is recorded in the university's financial statements as a result of the Asset Retirement Obligation standard. As part of the fiscal 2023 budget, the government provides a Capital Maintenance and Renewal (CMR) grant ($35 million) which is a main source of funding in dealing with the deferred maintenance liability. 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. This is also being done in the context of achieving our Facility and Space Optimization objectives which is underpinned by the Integrated Asset Management Strategy.