UNIVERSITY OF ALBERTA

Financial Statement Discussion and Analysis

For the Year Ended
March 31, 2017

The 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.
http://uofa.ualberta.ca/reporting

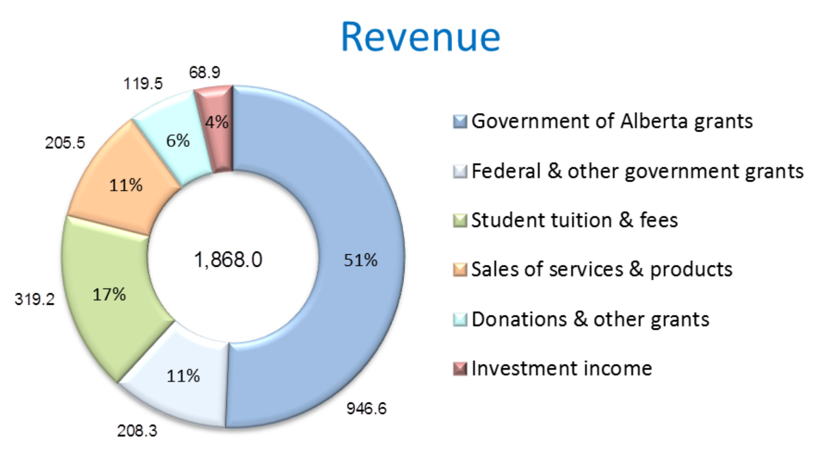
The financial statement discussion and analysis provides an overview of the university's:

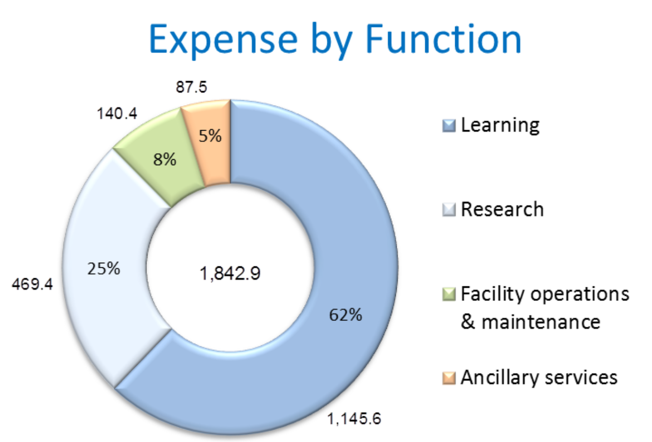
- Summary of Financial Results
- Revenue and Expense
- Capital Acquisitions
- Net Debt
- Net Assets
- Areas of Significant Financial Risk

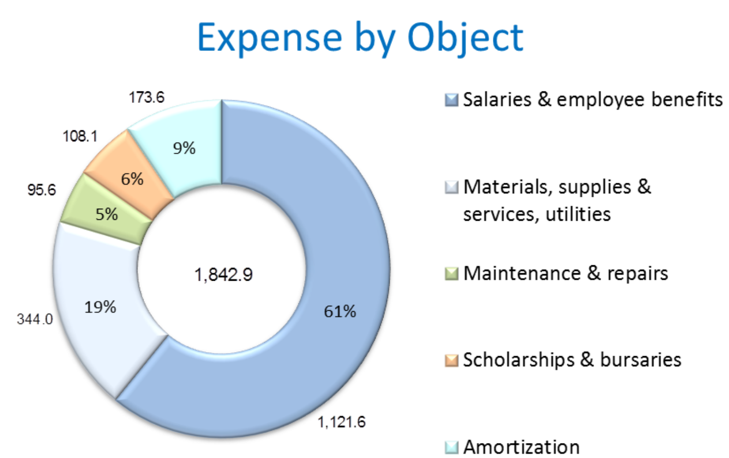
Summary of Financial Results

The university ended the year with an annual surplus of $83.4 million. Of this amount $58.3 million are donations directed to endowments and endowment capitalized investment income and therefore are not available for spending. The annual operating surplus of $25.1 million (budget: $37.6; 2% of total revenue) was primarily used for purchases of capital assets and debt repayment.

Net assets of $1,873.2 million increased from the prior year (2016: $1,677.3). The increase is mainly due to an increase in endowments.

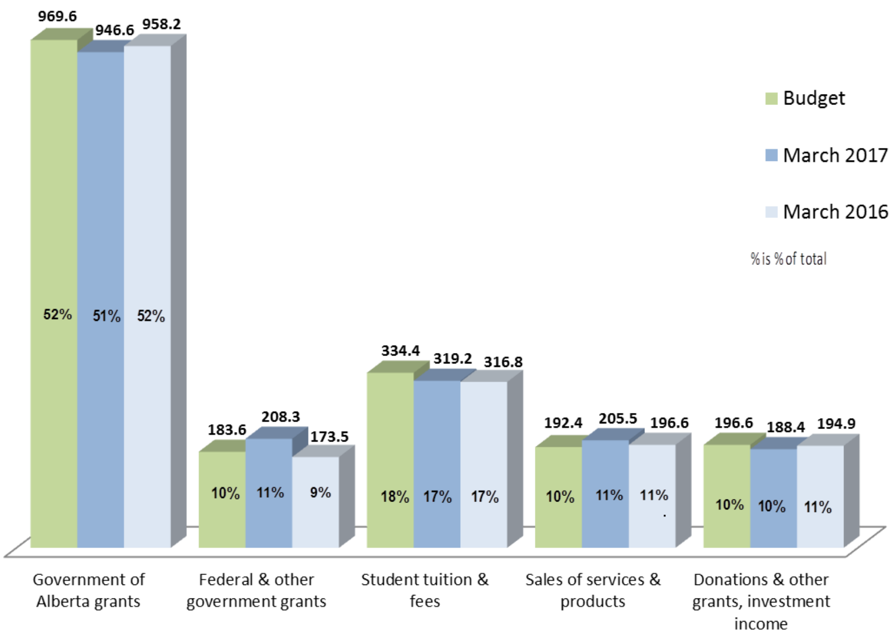






Revenue

Total revenue for the period was $1,868.0 million, an increase of $28.0 million over the prior year and $8.6 million (0.5%) less than budget. Government of Alberta grants are the single largest source of university revenue at 51% of total revenue.



Government of Alberta grants (GoA) represent the university's single largest source of funding for university activities. The GoA has increased the Campus Alberta grant (base operating grant) by 2%. GoA grants are comparable to budget. Although grants received for restricted purposes were greater than prior year, the expenditures were less than budget, thereby deferring the recognition of this grant revenue until next year.

Federal and other government grants primarily support the university's research activities. Grants are more than budget due to higher than budgeted expenditures, thereby recognizing more than budgeted revenue.

Student tuition and fees budget has remained relatively unchanged from prior year. Tuition includes instructional fees (linked to annual CPI increase), market modifiers, program differential fees and international student fees. In June 2015 the GoA announced a two year regulated tuition freeze. In October 2016 the GoA announced that this freeze will be extended to 2018. GoA has replaced this funding with an infusion of cash that is reflected in GoA grant revenues.

Student tuition and fees is less than budget mainly due to lower than budgeted enrolment. (enrolment - $4.0; enrolment with market modifiers and program differentials - $9.4)

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 $94.8 million, while other units generated sales of $110.7 million. Sales revenue is slightly more than budget.

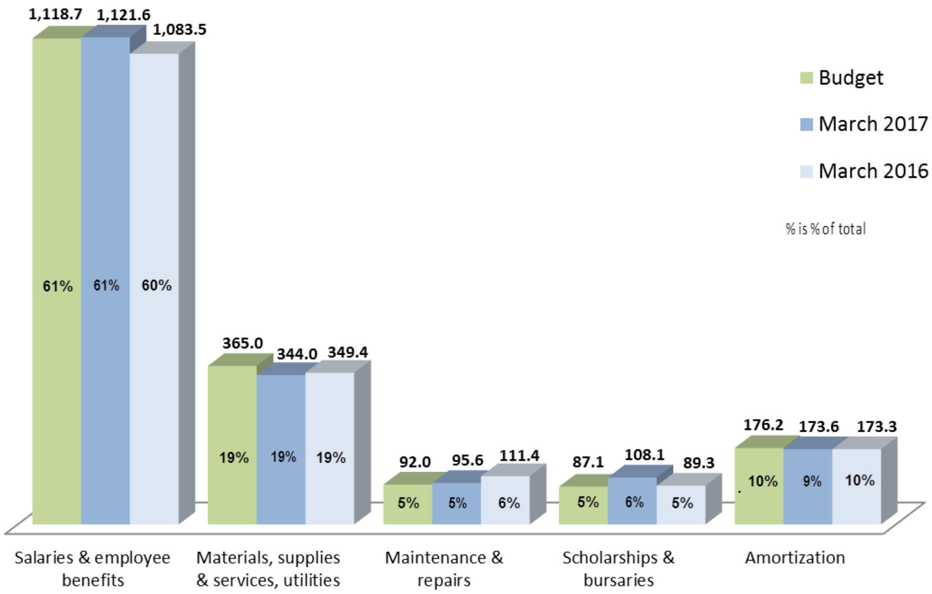
Donations and other grants support many university activities. Revenue is less than budget due to less than anticipated expenditures in the restricted funds, thereby deferring the recognition of some grants and donations until next year.

Investment income is $6.2 million more than budget. Investments fall into two categories, the Unitized Endowment Pool (UEP) and the Non-Endowed Investment Pool (NEIP). The UEP had a return of 14.9% (2016: (0.4%) loss) 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 4.4% (2016: 0.6% return).

Expense

Total expense for the year was $1,842.9 million, an increase of $36.0 million over the prior year and $3.9 million (0.2%) more than budget. Salaries and employee benefits are the single largest expense representing 61% of total expense.

Expense by Object



Salaries and employee benefits are comparable to budget.

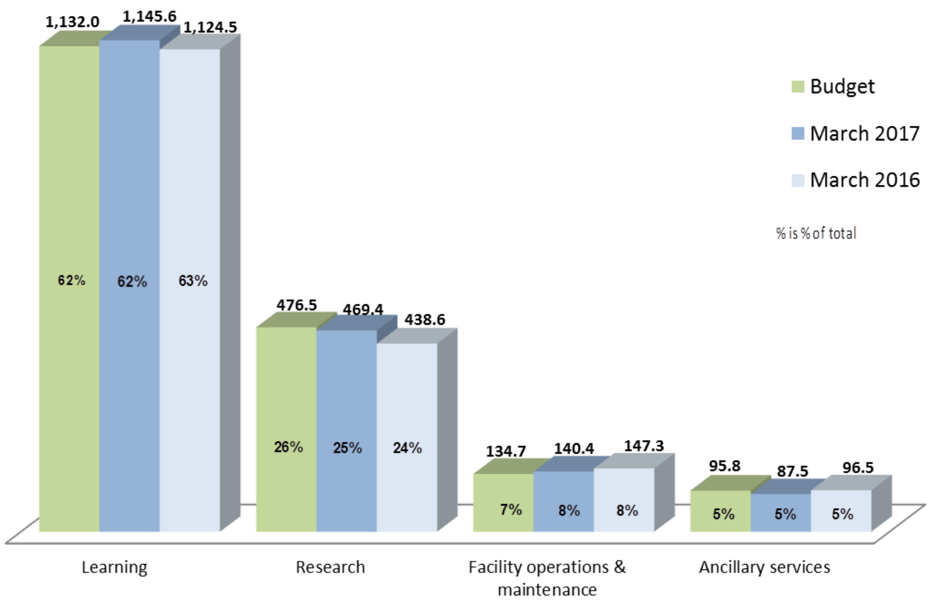
Materials, supplies and services are comparable to budget. Utilities are less than budget due to lower than budgeted utility rates.

Maintenance and repairs is comparable to budget.

Scholarships and bursaries are more than budget due to graduate scholarships (not budgeted) in the research fund and a change in the graduate student agreement. Under the new agreement graduate research assistantship fellowship payments that had previously been paid as salaries are now paid as bursaries.

Amortization is comparable to budget.

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 represents non-research activity funded though restricted grants and donations and includes undergraduate student scholarships, student bursaries, teaching and learning programs, and community service. This expense is comparable to budget.

Research activities expenses are funded by restricted grants and donations as well as internal funds designated for research related spending. This expense is comparable to budget.

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 are less than budget mainly due to lower utility rates.

Capital Acquisitions

The university expended $145.3 million (March 2016: $149.9) on construction and other tangible capital asset acquisitions.

The most significant construction and capital asset acquisitions in 2017 are:
- Three new residence construction projects - Peter Lougheed Hall, East Campus Village and Lister
- Research Collections Resource Facility - a new facility to replace the existing document storage site
- University of Alberta Botanic Garden - Aga Khan Garden

(in millions of dollars)

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. University management monitors net financial assets (net debt) excluding portfolio investments restricted for endowments, as these are the assets the university has available for future spending.

The net debt (excluding portfolio investments restricted for endowments) indicates that the university has a $227.4 million deficiency (2016: $234.0 deficiency). The deficiency can be attributed to employee future benefit liabilities (2017: $251.1; 2016: $259.1) which include the Universities Academic Pension Plan (UAPP) (2017: $157.6; 2016: $170.7) and other benefit plans such as supplementary retirement, long-term disability and early retirement (2017: $93.5; 2016: $88.4). The UAPP has a plan in place to address the unfunded liability and the university plans to use working capital to fund the other benefit plans (refer to the employee future benefit liabilities note in the financial statements for further information).

Net Assets

The net assets measure provides the net economic position of the university from all years of operations. Net assets are comprised of:

	March 2017	March 2016
Endowments	**$ 1,304.3**	$ 1,149.7
Investment in tangible capital assets	**585.0**	551.4
Accumulated deficit from operations	**(16.1)**	(23.8)
Net assets	**$ 1,873.2**	$ 1,677.3

Endowments represent contributions from donors that are required to be maintained intact 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. Therefore endowments are not available for spending. The university's endowment spending policy provides for an annual spending allocation to support a variety of key initiatives in the areas of academic programs, chairs and professorships, scholarships, bursaries and research. The increase to endowments of $154.6 million is due to new donations ($34.7) and capitalized investment income ($119.9). The endowment spending allocation was $36.8 million (2016: $35.7).

The $33.6 million increase in tangible capital assets consists of acquisitions ($97.5) and debt repayments ($10.5), less new financing ($15.2) and amortization ($59.2).

The accumulated deficit from operations was reduced by $7.7 million.

Areas of Significant Financial Risk

The university operates in a complex environment and must deal with a variety of risks which it manages through its integrated enterprise risk management framework. The major risks that can affect the university from a financial perspective are as follows:

Provincial Funding and Tuition Fees

The Campus Alberta grant is the primary source of funding for the university's day to day operating activities. Any reduction in the Campus Alberta or Academic Alternative Relationship Plans (AARP) grants result in significant budgetary pressure. AARP grants provide funding for a significant number of professors in the Faculty of Medicine and Dentistry permitting them to do teaching and research as well as clinical practice.

The university recognizes that funding models are changing. Government support is under pressure given the province's fiscal outlook. Grants, tuition and other revenue generation initiatives are under government control, which puts significant pressure on university finances.

The province has announced a 2% Campus Alberta grant increase for fiscal 2018. Tuition fees will remain frozen until fall of 2018 while the tuition regulations undergo review. Unlike fiscal 2017, no tuition backfill funding will be provided. In addition the province is reviewing the post-secondary funding model. The impact to university revenue of a 1% change to the Campus Alberta Grant is $6.2 million and a 1% change to tuition is $1.5 million.

Salaries and Employee Benefits

The province has passed legislation that brings all academic employees under the *Labour Relations Code*, thereby granting the university's staff associations all the rights and remedies that are granted to unions under the *Code*, including the right to strike and the right to lock-out employees. The university will also be required to negotiate essential services agreements for both academic and support staff. These changes will have an impact on future salary negotiations.

In June 2016, the Federal and Provincial Finance Ministers agreed to enhance the Canada Pension Plan (CPP). The impact of the increases to employer basic CPP contribution rates will be an additional $1 million in each year 2019 through 2023, $2.5 million thereafter.

Pension and Employee Future Benefits

The university currently carries a liability of approximately $251 million for employee future benefits, representing probable future payments for benefits earned to date. This balance can change for many reasons outside the university's control, including discount rates, salary escalation and inflation.

The university's cost of benefits is expected to increase by between 5% and 7% per year in the upcoming years and this is not sustainable. Approximately 61% of the university's non-pension benefit costs relate to programs the university and its staff co-operatively manage and which are bargained with our staff associations.

The largest of the unfunded liabilities is the university's share of the UAPP, which is approximately $158 million, based on the current actuarial assumptions. 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 $54 million, a 1% increase in the salary escalation assumption would be an increase of approximately $12 million, while a decrease of 0.25% in the discount rate assumption would lead to an increase of approximately $28 million. The continuing increase in pension plan contributions represents a significant risk. Without structural reforms to the pension plans, the level of pension plan contributions as a percentage of total benefit costs could become a recruitment impediment.

Information Technology

Information technology (IT) costs are over $90 million per year. IT deferred maintenance is becoming more of a risk as usage and reliance continues to grow against an aging infrastructure. There are risks in this area that could result in financial and reputational issues. The university remains vigilant and proactive in addressing risks to its systems and information.

Deferred Maintenance

As the largest and oldest post-secondary institution in the province, the university's deferred maintenance continues to increase and is estimated at $938 million in 2016. This level of deferred maintenance could result in a significant building system failure, negatively impacting the university's operations.