

## OPERATING SURPLUSES

As mandated by the *Post-secondary Learning Act*, the University presents a balanced budget each year for approval by the Board of Governors. It is not unusual to experience variations in the annual operating surplus due to unanticipated fluctuations in revenue and expenses. The University's annual operating surplus, which is the excess of revenue over expense, is shown on the Statement of Operations in the audited [Financial Statements](#).

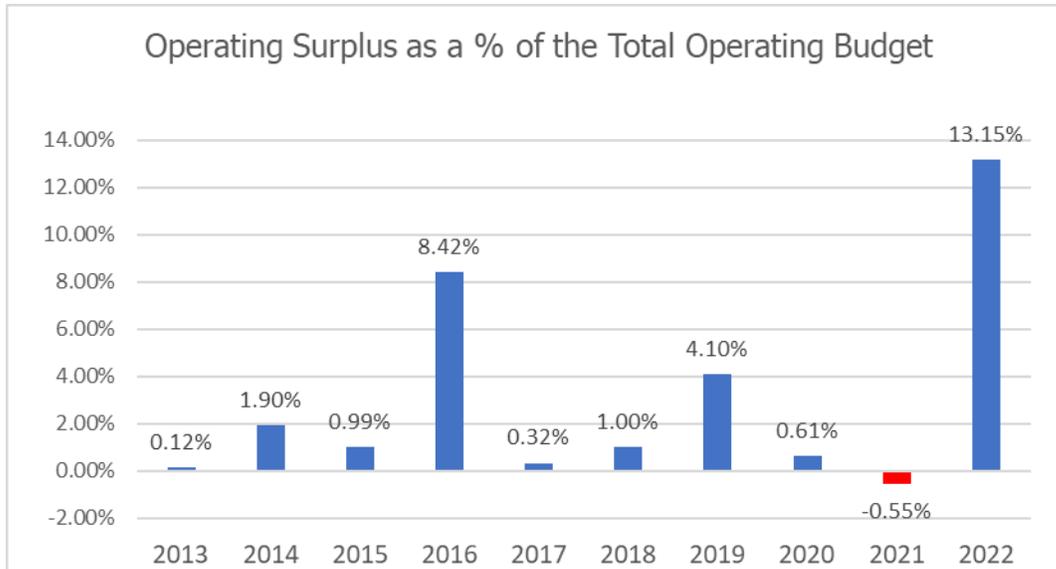
The University normally approves annual breakeven operating budgets and any realized annual operating surpluses (deficits) are generally not on-going since they are the result of events or circumstances which occur in a particular fiscal year that are not anticipated to happen in future years. Typically, the University's annual operating surpluses are attributed to savings in employee position funds as a result of the length of time taken to fill budgeted positions, fluctuations in investment income beyond anticipated returns, fluctuations in the US dollar exchange rate and cost controls in the areas of materials and services. A one-time surplus may also be realized if there is a time delay between when an initial program grant is received and when the costs are incurred due to the time needed to recruit faculty and staff and establish the infrastructure required for the new program.

Normal operating surpluses over the past ten years have tended to be less than 4% of annual operating expenses, as deviations from budget are fairly small and available operating funds have been decreasing. Occasionally, however, larger operating surpluses occur due to more exceptional circumstances. Over the past 10 years, when operating surpluses have exceeded 6% of operating expenses, it has principally been due to investment income that significantly exceeded budget. In 2016 and 2022 the significant increase in investment income was a result of changes in our investment managers which triggered the transferring of unrealized investment income from the Statement of Remeasurement Gains and Losses to realized investment income in the Statement of Operations. These one-time realized gains in the investment income were reinvested in our special purpose funds as per the conditions of these funds, and thus are not available for general operation spending.

### [Able to Use Operating Surpluses to offset Deficit Budgets?](#)

Operating surpluses typically are a result of one-time savings that occurred in the fiscal year and thus they are not available to reduce any continuing operating budget reductions that may be required to balance future years' budgets.

It is useful to keep in mind that the annual operating budget surpluses, with the exception of 2016 and 2022 due to extraordinary investment income gains, do not represent a substantial percentage of the total annual operating budget, as illustrated in the following chart.



**How are surpluses considered when developing the University budget?**

If a surplus is the result of an increase in revenue or a reduction in an expense that will be on-going and continuing into future years, the value of that surplus can be used to offset any required future budget reductions.

If the surplus is a result of a one-time event that is not anticipated to be repeated, then that surplus cannot be used to balance any future budgets, for example realized investment income as a result of a change in investment managers. A related example of a one-time event is the \$400 bonus cheques that were distributed to each Albertan in 2006 from the Provincial surpluses. This was a one-time income increase for all Albertans but not one that could be counted on in future years and thus individuals should not have increased their on-going spending by \$400 as a result of this “windfall cheque”.

**What does the University do with its operating surpluses?**

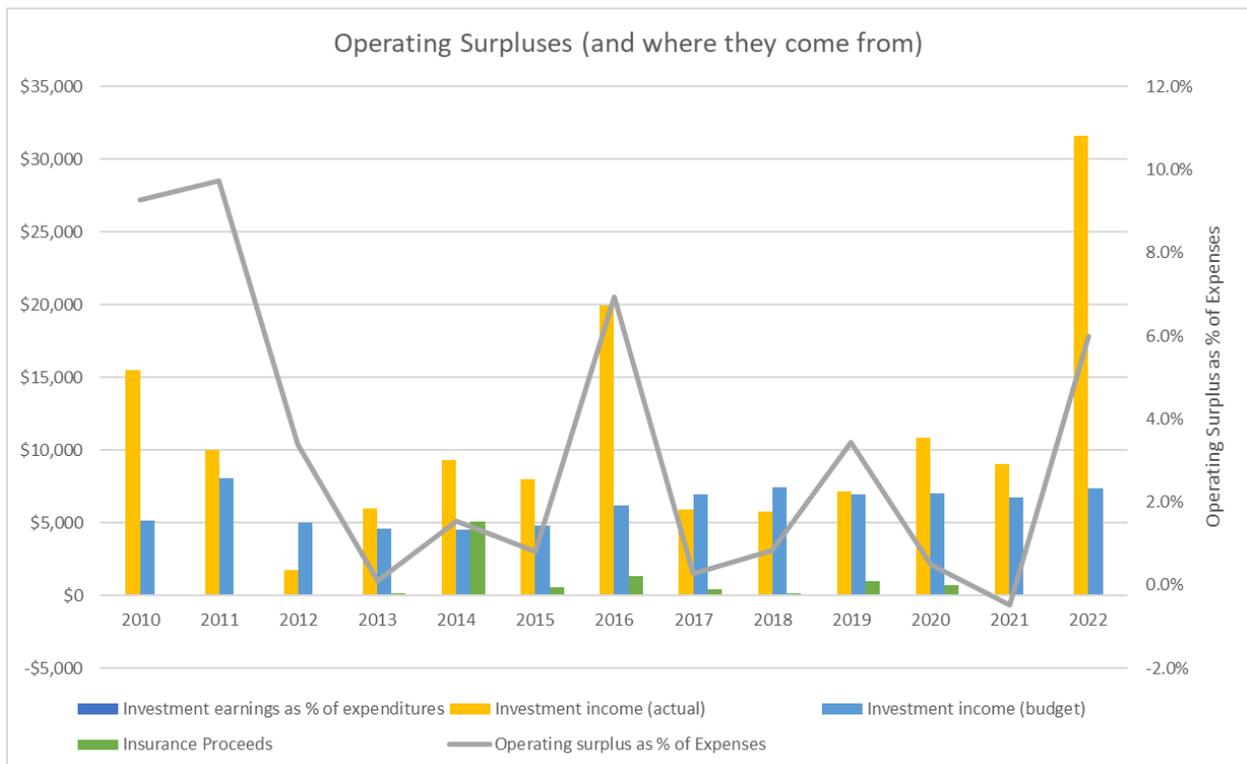
If there is an annual University operating surplus it generally has been used to address University strategic priority projects, such as the Science Commons construction project, information systems revitalization projects, student residence construction, essential maintenance projects, faculty research start-up costs, pilot projects for program expansion and new programs, and student recruitment and retention strategies.

It is important to emphasize that operating surpluses and reserves are funds that are available only on a one-time basis, which are not automatically replenished annually, and they are not funds that can be used to cover on-going or continuing deficits that exist in the University's operating budget.

Similar to a personal savings account, these funds may serve as an important cushion to cover one-off expenses in the case of an emergency or an unanticipated need for cash. The significant negative financial impact of the COVID-19 global pandemic of \$11.4 million (\$6.9 million 2020-21; \$4.8 million 2021-22), is a prime example of why the University requires reserves to respond to such unexpected financial needs.

### Significant Operating Surplus in 2022

As shown in the figure below, the University has a significant operating surplus in 2022, due to a change in investment managers that involved selling and reinvesting the University’s investments. All of the investment income growth accumulated over previous years that was realised when selling the investments held with the previous investment managers was reinvested in purchasing the new investments held with the new investment managers. The reinvestment of the income is in accordance with the conditions of the endowment and special purpose funds, and thus the one-time recorded realized investment income is not available for general operation spending. Similar events have occurred in previous years, as we see in the graph below. An overview of why the surpluses in 2022 and previous years occurred without a surplus of operating funds being available to spend for on-going operational expenses follows.



## BUDGET BRIEF CONTEXT FOR 2022-23 BUDGET

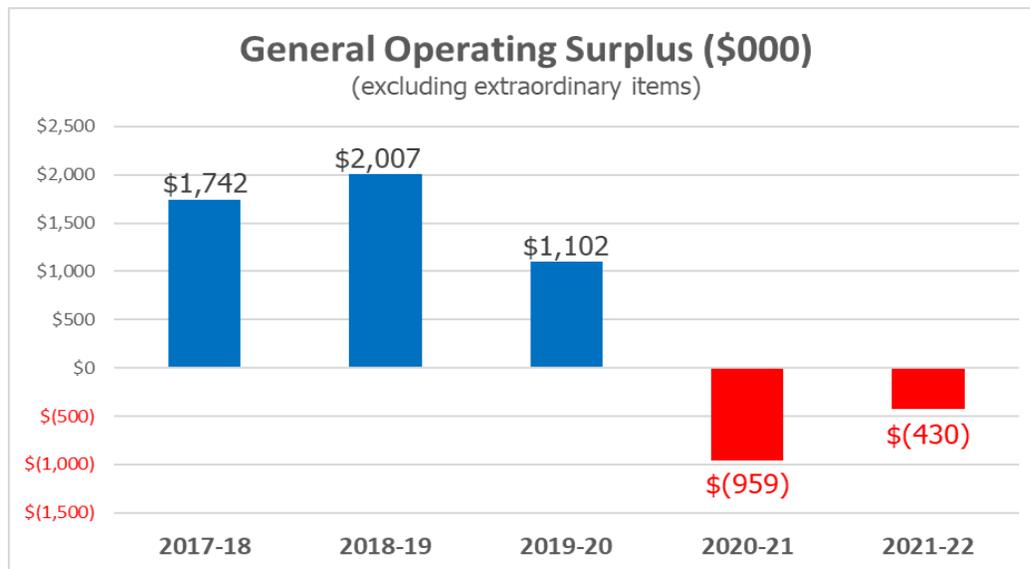
- 2010: The University ended the 2010 year with a \$16 million excess of revenue over expense. The major contributor to this excess was the recording in our financial statements previously unrealized investment income of \$17 million. The investment income, both realized and unrealized, for the year was \$15.5 million. The main reason for this was investment market condition improvements. There was an additional \$4.5 million which was recorded as a direct increase to endowment principal.
- 2011: The University experienced higher than budgeted investment income, a \$1.7 million one-time provincial transition grant to address budget challenges, and \$1.0 million one-time grant for lights on funding for Markin Hall and the Dr. Foster James Penny building, which resulted in a higher than budgeted surplus.
- 2016: The University reviewed its investment portfolio and approved a change in investment managers and the management of its investments from 2 to 3 investment managers. This change resulted in the realization of \$12.5 million in investment income in the statement of operations as investments were sold and new investments were purchased. All of the \$12.5 million investment gains were reinvested as per endowment and special purpose fund conditions and thus the funds were not available for operating expenditures. If the \$12.5 million investment income had not been reported on the statement of operations the annual surplus would have been \$1.6 million, rather than the \$14.1 million reported on the 2015-16 audited financial statements. Proceeds of \$1.3 million from insurance claims from a burst pipe in University Hall in 2015, hail damage from 2013, and flooding in 2013 was also received.
- 2019: The surplus was higher primarily due to a \$4.3 million reduction in the actuarially determined pension expense for the Universities Academic Pension Plan (UAPP) and the receipt of \$1 million insurance proceeds as a result of University Hall flood damage in 2016. The \$4.3 million pension expense reduction was not available to the University to fund its operations as it is held within the UAPP.
- 2021: A deficit was experienced by the University in 2020-21 due to the COVID-19 global pandemic and the significant negative financial impact it had on the finances of the institution. The suspension of most of the on-campus operations resulted in significant revenue losses, especially for Ancillary Services. The total cost of the pandemic in 2020-21 was \$6.9 million.
- 2022: The significant variances in projected versus budgeted investment income are due to the realized investment income from the transition to 4 new investment managers (global equities, Canadian equities, fixed income, and alternative investment managers). As a result of the transition to the new investment managers the University recognized \$22 million in realized investment income in the Statement of Operations which were previously reported in the Statement of Remeasurement Gains and Losses, all of which has been reinvested with the new investment managers as per the endowment and special purpose fund conditions.

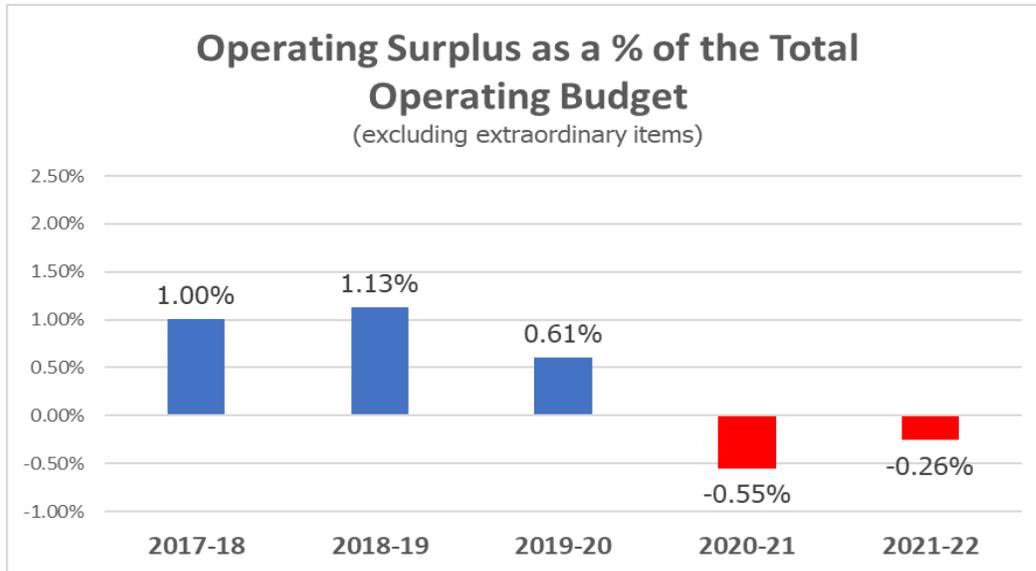
**Operating Surpluses, excluding extraordinary income**

As explained above, in some years there are income and expenses that are not part of the regular operations of the institution but they do impact the financial "bottom line" in the financial statements, in particular the statement of operations.

If the extraordinary income were excluded from the "bottom line" as they are funds that are not available to spend on the operations of the University, the surpluses would not be a significant percentage of the University's operating budget. The extraordinary items removed from the annual operating surpluses are the realized investment income due to changes in investment managers and portfolios, insurance proceeds and the UAPP actuarial reduction.

<b>AUDITED FINANCIAL STATEMENTS (Consolidated Statement of Operations)</b>						
(\$000)		2017-18	2018-19	2019-20	2020-21	2021-22
Annual Operating Surplus		\$ 1,742	\$ 7,307	\$ 1,102	\$ (959)	\$ 22,094
Less: Realized investment income due to changes in investment managers and portfolio						\$ (22,222)
Less: insurance proceeds			\$ (1,000)			\$ (302)
Less: UAPP actuarial reduction			\$ (4,300)			
Annual Operating Surplus less extraordinary items		\$ 1,742	\$ 2,007	\$ 1,102	\$ (959)	\$ (430)





### Realized and Unrealized Investment Income and Losses

The University's financial statements are prepared in accordance with Canadian Public Sector Accounting Standards (PSAS). Using PSAS, unrealized investment income and losses are reported on the Statement of Remeasurement Gains and Losses, but when they are realized the investment gains and losses are transferred to the Statement of Operations.

As stated above, in 2022 the University changed investment managers, which resulted in realizing investment portfolio income of approximately \$41 million with unrealized gains previously reported on the statement of remeasurement of gains and losses. This amount includes \$12 million allocated to endowments which is not included in investment income on the Statement of Operations since it is recorded as a direct endowment increase. Realized investment earnings are offset by unrealized losses of \$33 million which are reported on the Statement of Remeasurement of Gains and Losses and not the Statement of Operations.

The following chart shows that the net cumulative investment returns (investment income reported on the Statement of Operations less the unrealized investment losses) resulted in essentially breakeven investment returns as of March 31, 2022. This illustrates the volatility of the investment market environment at year end.

