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 or 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.

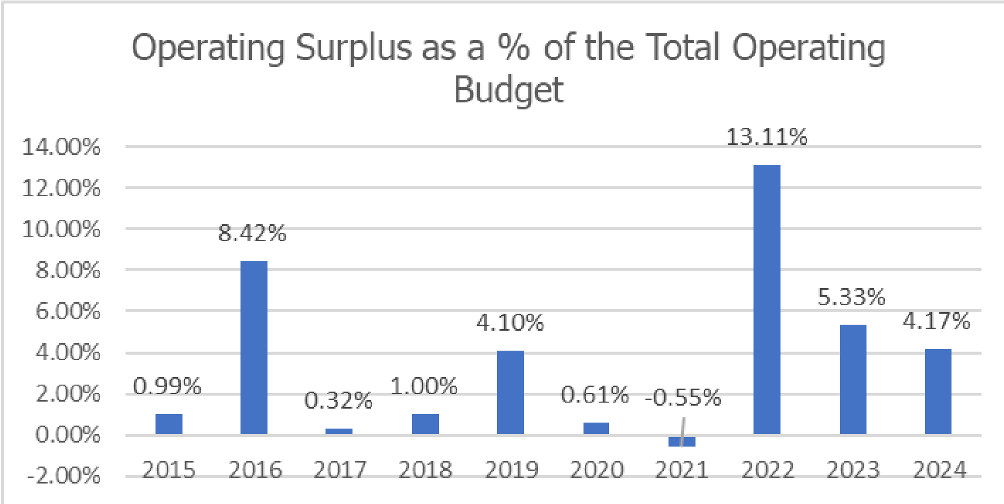
The University normally approves annual breakeven operating budgets and any realized annual operating surpluses (deficits) are generally not on-going since they are the result of events or circumstances which occur in a fiscal year which are not anticipated to happen in future years. Typically, the University's 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 or special conditional 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 years 2016 and 2022 the significant increase in investment income was a result of changes in our investment managers which triggered the recording of unrealized investment income to realized in our financial statements. These one-time realized gains in the investment income are reinvested in our endowment and 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.

Overall, it is useful to keep in mind that the annual operating budget surpluses 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 the 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 as a result of this "windfall cheque".

What does the University do with its operating surpluses?

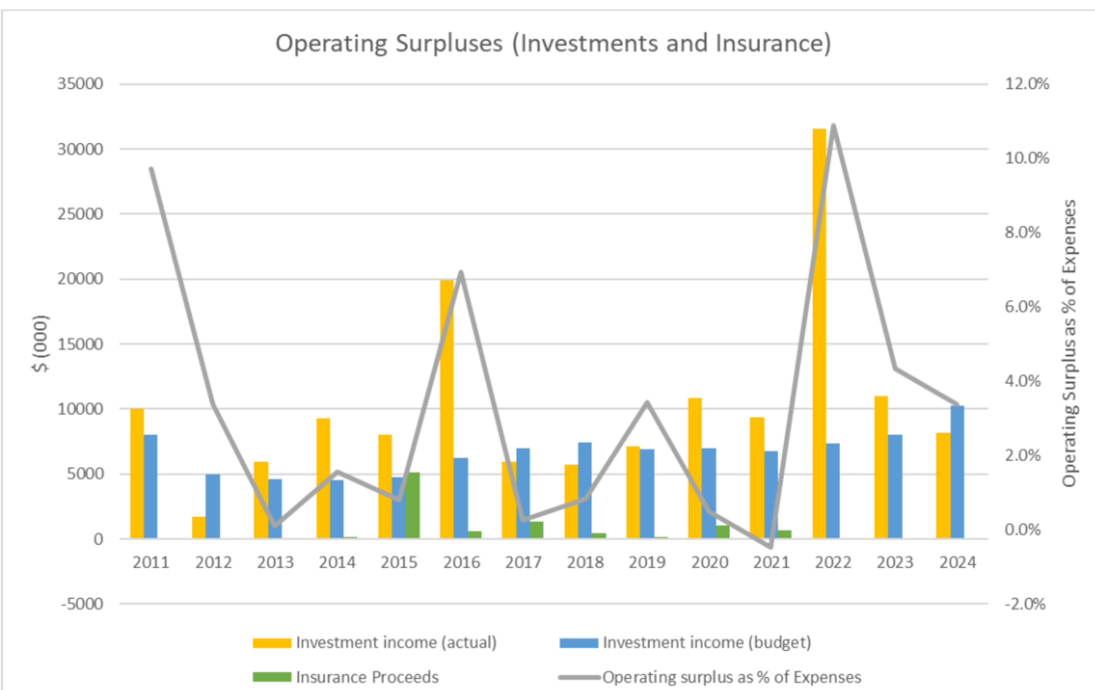
If there is an annual University operating surplus, it generally has been used to address University strategic priority projects e.g., the Science Commons construction project, information systems revitalization projects, student residence construction or essential maintenance, faculty research start-up costs, pilot projects for program expansion and new programs, and student recruitment and retention strategies. Proposed expenditures from operating surpluses are made in alignment with the University's Strategic Plan and are recommended by the Budget Advisory Committee to the Board of Governors for approval following input from both the University Strategic Planning Committee and General Faculties Council.

It is important to emphasize that operating surpluses/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, which was $11.4 million for the period March 2020 to October 2021, is a prime example of why the University requires unrestricted reserves to respond to such unexpected financial needs.

Significant Operating Surplus in 2022

As shown in the figure below, the University saw 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 growth that was realised when selling the investments held with the previous investment managers was reinvested in purchasing the new investments held with the new managers, 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.



- 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 the 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 and the receipt of $1 million insurance proceeds as a result of University Hall flood damage in 2016.
- 2022: The significant variances in projected versus budgeted investment income were due to the realized investment income from the transition of four investment managers (global equities, Canadian equities, fixed income, and alternative investment managers). As a result of the transition of the investment managers the University recognized approximately $30 million in realized investment income in 2022, all of which was reinvested with the new investment managers as per the endowment and special purpose fund conditions.
- 2023 and 2024: The 2022-2023 and 2023-2024 annual surpluses of $12.3 million and $7.3 million resulted primarily from delayed position replacements, increased international student enrolments, and higher than expected non-endowment investment returns