THE UNIVERSITY OF BRITISH COLUMBIA

REPORT TO THE BOARD OF GOVERNORS
Agenda Item #6.1

SUBJECT	**2016-2017 THIRD QUARTER FINANCIAL REPORT**
MEETING DATE	**APRIL 13, 2017**

Forwarded to the Board of Governors on the Recommendation of the President

APPROVED FOR SUBMISSION

Santa J. Ono, President and Vice-Chancellor

For Information

Report Date	March 16, 2017
Presented By	Andrew Simpson, Vice-President Finance & Operations Ian Burgess, Comptroller Naureen Ali, Associate Director, Financial Reporting

EXECUTIVE SUMMARY

The 2016-2017 Third Quarter Financial Report for The University of British Columbia is presented for information to the Board of Governors.

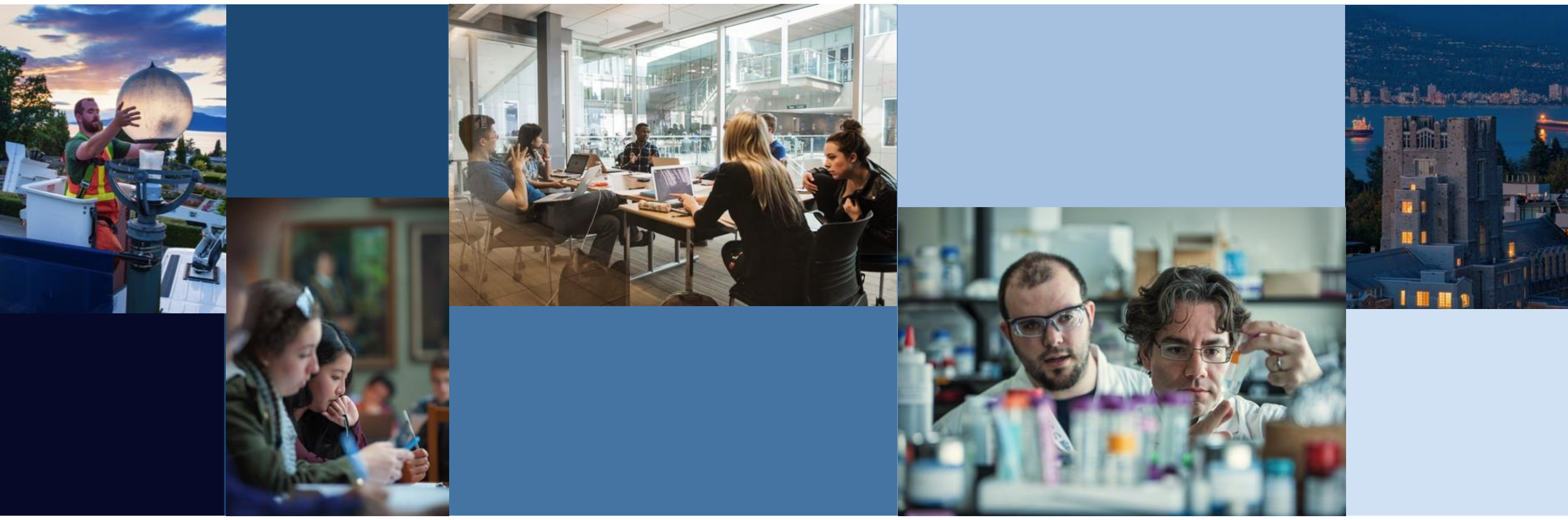
The Q3 consolidated results reflect a surplus of $26m and a full year consolidated forecast surplus of $70m, an increase of $43m from the Q2 forecast of $27m. The majority of this surplus is derived from the use of current revenues to support capital spending, whereby the expense is reflected over the life of the asset. Only $7m comes from an increase in cash reserves, primarily in the faculty areas. The results delays in spending of increased operating revenues as Faculties continue to find it difficult to recruit new faculty. As well, Faculties that have been running deficits in the past, such as Medicine, Law, Education and Pharmaceutical Sciences, have made significant strides in balancing their budgets.

The forecast and budget reflect estimates made by Faculties and operating units, which by nature can be conservative. While it is difficult to predict the actual year-end result, we may see an improvement over these estimates, although less of an increase than seen in prior years because of the improvement reflected in the Q3 forecast. As well, our year end work may identify the need for accounting adjustments that are not reflected in these numbers.

INSTITUTIONAL STRATEGIC PRIORITIES SUPPORTED

☐ **Learning** ☐ **Research** ☐ **Innovation** ☐ **Engagement (Internal / External)** ☐ **International**

or ✔ **Operational**



2016-2017 Third Quarter Financial Report

Financial Reporting and Budgeting
March, 2017

THE UNIVERSITY OF BRITISH COLUMBIA

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1. Executive Summary

Overview

Consolidated Highlights

The 2016/17 Third Quarter Financial Report for the University of British Columbia (UBC) is presented for information to the Board of Governors.

The Q3 consolidated results reflect a surplus of $26m and a full year consolidated forecast surplus of $70m, an increase of $43m from the Q2 forecast of $27m. The improvement from the Q2 full year forecast surplus is the result of stronger than expected international tuition revenue, notably in the Faculties of Arts and Science, from increased revenue from Sauder's Real Estate pre-licencing program, and from Student Housing and Hospitality Services. The results also reflect hiring delays as faculties continue to find it difficult to recruit new faculty. As well, faculties which have been running deficits in the past, such as Medicine, Law, Education and Pharmaceutical Sciences, have made significant strides in balancing their budgets.

The forecast and budget reflect estimates made by faculties and operating units, which by nature can be conservative. While it is difficult to predict the actual year-end result, we may see an improvement over these estimates, although less of an increase than seen in prior years because of the improvement reflected in the Q3 forecast. As well, our year-end work may identify the need for accounting adjustments which are not reflected in these numbers.

Our fiscal strategy calls for a consolidated surplus in the range of 1-3% of total revenues, or between $24m and $71m.

The forecast surplus reflects:

- Expected income from endowments which is being recapitalized to ensure the principal maintains its purchasing power over time;
- Income recognized from long term lease revenues which have been endowed; and
- Amounts invested to maintain our investments in capital assets.

Operating Highlights

The operating forecast is projecting $9m of unallocated revenues at year-end, which will be able to support strategic investments in the 2017/18 budget.

Operating units are projecting overall increases to their reserves totaling $7m, as compared to drawdowns of $25m projected at Q2. We are also projecting increased investment in capital during the year, totaling $45m, up from $36m at Q2. As well, investment results are better than originally budgeted, yielding an additional $3m reported income on endowments for the year.

In order to manage the unexpected financial impact of the interest arbitration decision handed down last year, Faculties have had to reprioritize their activities. At the same time, the university has reallocated funding from other priorities to assist the Faculties.

The UBC Excellence fund, derived from recent international tuition increases, totals $6m for 2016/17. This is being used to support recruiting and retaining faculty, students and staff, supporting research, and improving the student experience.

Faculties in Structural Deficit

Several faculties are working with structural deficits as revenues available to these faculties have not increased enough to cover increased salary costs, particularly as we manage the progress through the ranks paid to faculty, and the additional costs of the most recent interest arbitration settlement which result in 3% (on an annual basis) of faculty salaries remaining unfunded from the province. At the same time, the end of mandatory retirement has resulted in a general aging of faculty demographics, and a resulting increase in faculty salary cost.

While revenue from international tuition has helped some faculties manage these pressures, the Faculties of Medicine, Education, Pharmaceutical Sciences and Law are struggling as professional programs are constrained in their ability to enroll international students. They have implemented a variety of strategies to manage these pressures including eliminating unnecessary programs, faculty hiring freezes, implementing new programs, or reducing staff, and as a result are showing much improved financial results for the year.

2. Consolidated Forecast

Consolidated Statement of Operations (by Object)

CONSOLIDATED STATEMENT OF OPERATIONS (By Object)

	Q3 Year to date			Full Year			2015/16
(in $millions)	Actual	Budget	Variance	Forecast	Budget	Variance	Actual
Revenues							
Government grants and contracts							
Government of Canada	182	251	(69)	282	335	(53)	305
Province of British Columbia	566	558	8	743	745	(2)	738
Other governments	10	15	(5)	19	20	(1)	17
Other contributions	139	110	29	181	146	35	157
Student fees	375	364	11	616	601	15	560
Investment income	46	39	7	67	61	6	82
Income from Gov't Business Enterprises	4	-	4	2	-	2	2
Sales and services	235	220	15	365	354	11	332
Amortization of deferred capital contributions	58	57	1	83	80	3	76
	1,615	1,614	1	2,358	2,342	16	2,269
Expenses							
Salaries & benefits	1,004	1,036	32	1,380	1,414	34	1,343
Operating costs - other	253	260	7	416	421	5	399
Capital asset amortization	140	140	-	194	197	3	182
Cost of goods sold	27	29	2	39	40	1	38
Scholarships, fellowships and bursaries	65	77	12	114	107	(7)	112
Grants to third parties	84	97	13	126	130	4	121
Debt service costs	16	16	-	19	19	-	21
	1,589	1,655	66	2,288	2,327	39	2,216
Surplus/(Deficit) from operations	**26**	**(41)**	**67**	**70**	**15**	**55**	**53**

The full year consolidated surplus forecast is $70m, a $55m improvement from a budgeted surplus of $15m. The increase is attributed to higher than expected international tuition revenue, increased housing revenue and better investment returns on endowments. Refer to “Income Statement Analysis” in the following section for further details.

The year to date surplus of $26m is favourable to budget mainly due to timing differences in salaries and benefits, scholarships, fellowships and bursaries, and grants to third parties. As described below, these are expected to reverse in part by year end.

Revenue

- **Government of Canada** – This revenue is mainly attributed to research activities. A portion of the federal funds received goes towards indirect costs of research, but most revenue pertains to Tri-council grants, recognized to the extent expenses are incurred in associated research projects. Further details on accounting treatment are discussed in “4. Research”. Year to date and full year forecast would deviate from budget as research project plans change. In most cases, such activity has no impact on the bottom line.
- **Province of British Columbia –** This revenue is mainly operating grants. Full year forecast includes additional funding for salary increases within the provincial mandate.
- **Other contributions** – This revenue is generated from research grants and donations received by associations, businesses and industry, and individuals, mainly for restricted purposes. Thus, revenue is recognized to the extent that expenses have been incurred. Year to date and full year forecast would deviate from budget as research project plans change. In most cases, any such charge would have no impact on the bottom line.
- **Student fees** – This category includes tuition and mandatory fees for undergraduate and graduate students, international and domestic.

- **Investment income** – Current accounting standards require recognition of all realized gains and losses on the Statement of Operations. The budget assumes a total long–term annual rate of return for endowment investments of 6.15% which has been set by IMANT. For the nine months to December 31, actual returns of 7.8% have exceeded the pro rata long-term rate of return, resulting in a projected improvement over budget for the full year.
- **Sales and services** – This category includes ancillary operating revenue in housing and conferences, food services, bookstore, parking and fee for service activities across campus. Full year and year to date favourable variances are largely due to better than expected growth in housing and conference operations, food services, and parking services revenues.

Expenses

- **Salaries and benefits** – Year to date expenses are lower than budget as the budget assumes even recognition of salaries throughout the year, whereas there are some salaries (such as sessional lecturers, teaching assistants, temporary staff, research assistants, etc.) which are typically incurred during the academic year. Full year expenses are lower than forecast mainly due to savings in the Faculty of Medicine due to retirements, attrition, and delayed hiring for specific initiatives, as well as one-time hiring delays in Building Operations, Energy and Water Services, Development, and Alumni Engagement.
- **Grants to third parties –** The University collaborates on several multi-institutional projects. The year to date and full year variances are mainly driven by timing differences from original budget in research and specific purpose projects.
- **Scholarships, fellowships and bursaries** – Year to date variance is due to timing, as Student Financial Aid for International students will be paid out in the fourth quarter. Full year budget is higher than forecast due to an expected increase in awards spent from endowments.

Income Statement Analysis

	Full Year		
(in $millions)	Forecast	Budget	Variance
UBC Vancouver faculties	16	(9)	25
UBC Vancouver administrative units	(8)	(11)	3
UBC Okanagan	(1)	(2)	1
Sub-total Operating Units	7	(22)	29
Deferred land sales	7	7	-
Endowment surplus	11	8	3
Net investment in capital	45	22	23
Surplus	**70**	**15**	**55**

- The net result from Operating Units represents an increase in reserves by Faculties which are forecasting a favourable variance to budget as a result of better than expected growth in international tuition revenues. Offsetting this are Administrative units which are drawing down reserves for capital projects in Student Housing and Building Operations, and funding commitments by the Provost's Office to support faculties.
- Endowment surplus of $11m: This represents net income that is being added to the endowment principal to ensure that the spending allocation increases in future years to keep up with inflation.
- Deferred land lease income of $7m: Proceeds from leasing land for development is allocated to the endowment as it is received, and the revenue is recognized in the Statement of Operations over the period of the lease, 99 years.
- Surplus from net investment in capital: This represents the operating funds spent on capital assets during the year from current revenues or accumulated surpluses held by faculties or other operating units.

Consolidated Statement of Financial Position (unaudited)

Presented in classified format:

(in $ millions)	Dec 31, 2016	As at March 31		2015/16
	Actual	Forecast	Budget	Actual
ASSETS				
Current Assets				
Cash and cash equivalents	73	143	100	101
Accounts receivable	469	176	211	176
Operating investments	342	380	236	319
Investments in government business enterprises	70	17	(5)	17
Other current assets	18	17	18	18
	972	733	560	631
Non- Current Assets				
Endowment investments	1,490	1,468	1,469	1,462
Capital assets	3,174	3,309	3,319	3,100
	4,664	4,777	4,788	4,562
TOTAL ASSETS	5,636	5,509	5,348	5,193
LIABILITIES AND NET ASSETS				
Current Liabilities				
Accounts payable and accrued liabilities	482	285	251	279
Current portion of debt	6	6	8	6
	488	291	259	285
Non-Current Liabilities				
Employee future benefits	12	12	12	12
Deferred other restricted contributions	358	327	290	242
Non-current portion of debt	352	354	350	357
	722	693	652	611
Total Liabilities	1,210	984	911	896
Net Assets				
Accumulated surplus	1,811	1,852	1,776	1,751
Deferred capital contributions	1,421	1,469	1,454	1,414
Deferred land lease revenues	616	642	626	556
Deferred endowment contributions	578	562	581	576
	4,426	4,525	4,437	4,297
TOTAL LIABILITIES AND NET ASSETS	5,636	5,509	5,348	5,193

The University's Statement of Financial Position remains strong, with healthy working capital and funding to support ongoing investment in key strategic projects, which includes capital projects outlined in "3. Capital."

- The university cash position is represented here as cash and cash equivalents and operating investments. The favourable variance compared to budget is due to a $100m borrowing from the endowment.
- The large balance in accounts receivable relates to outstanding tuition receivable.
- Government business enterprises are accounted for such that the business entity's changes in equity are recorded as an investment to the extent it is not declared as a distribution. UBC Properties Investment Ltd. (UBCPIL) and Great Northern Way Campus Trust (GNW) are recorded in this manner. The large balance in investment in GBE is due to a significant land sale by UBCPIL in the first quarter. Land proceeds are distributed to UBC, which are then invested into the endowment.
- Changes in capital expenditures are presented in "3. Capital"
- The large balance in accounts payable largely relates to deferred tuition fees, to be recognized into income as term progresses.
- Contributions received for research, trust, endowment and capital and not yet spent are recorded as deferred contributions.
- Contributions expended on capital are referred to as deferred capital contributions.

3. Capital

The University makes significant ongoing capital investments to support its learning and research mission, and to create an outstanding student experience. Below is a summary of capital expenditures for 2016/17:

Capital expenditure by asset category (in $millions):

Summary Level (in $millions)	2016/17 Forecast	2016/17 Budget	Forecast to Budget Variance	2015/16 Actuals
Building and Property:				
Major Buildings	204	175	(29)	176
Building Renovations & Additions	54	56	2	60
Capital Infrastructure [1]	28	39	11	45
	286	270	(16)	281
Research equipment	45	41	(4)	22
Other equipment & furnishings	26	15	(11)	37
Information Technology	27	24	(3)	14
Library	18	17	(1)	18
Total Capital Expenditure	**402**	**367**	**(35)**	**372**

1 Capital Infrastructure includes improvemts to roads, lots, sewer, gas, water and electrical assets

Funding of capital expenditure (in $millions):

Summary Level (in $millions)	2016/17 Forecast	2016/17 Budget	Forecast to Budget Variance
Funding Source:			
Ministry (KDF/COA)	11	24	(13)
Ministry -Routine capital	35	59	(24)
Federal - CFI	11	8	3
Federal - SIF	22	-	22
Donations	60	26	34
	139	117	22
Internal Sources			
Unit/Central	146	135	11
IIC's	10	8	2
Internal Loans	107	107	0
	263	250	13
Total Funding	**402**	**367**	**35**

Major Buildings

Forecasted major building expenditures have increased compared to budget mainly due to delays in construction during 2015/16 that have run over to the new fiscal year, as well as accelerated progress on the Brock Commons Student Residence Phase 1 project. These increases over the 2016/17 budget for building projects include:

- Brock Commons Student Residence Phase 1 ($21m)
- Gage South Student Residence ($5m)
- Biomedical Research Centre ($2m)
- Henry Angus Tower Seismic Upgrades ($4m)

Building Renovations & Additions / Capital Infrastructure

Forecasted Expenditures for Building Renovations and Additions as well as forecasted expenditures for capital Infrastructure are lower than budget amounts as a result of the completion of the steam to hot water project earlier than planned.

Information Technology (IT)

Forecast 2016/17 includes $20m for Student Academic System Initiative (SASI), $3m for information security, and $1m for Customer Relationship management System (CRM).

Funding Sources

Forecasted funding for capital expenditures is $35m higher than originally budgeted due primarily to new Federal Strategic Infrastructure Program (SIF) funding and external donations. Units also project more capital spending through use of operating cash and use of more internal loans.

Net Investments in Capital

When UBC acquires tangible capital assets, the spending appears as a surplus in the Statement of Operations in the year of acquisition although the cash is spent. This is referred to as net investment in capital. The 2016/17 forecast net investment in capital is $45m, a $23m increase from budget, mainly driven by higher capital additions.

	Full Year			2015/16
(in $ millions)	Forecast	Budget	Variance	Actual
Capital asset additions	402	367	(35)	371
Funded externally	(139)	(121)	18	(84)
Increase in internal loans	(107)	(107)	-	(159)
Capital additions from operations	156	139	17	128
Depreciation	(194)	(197)	3	(182)
Amortization of deferred capital contributions	83	80	3	76
Net depreciation	(111)	(117)	6	(106)
Net investment in capital	**45**	**22**	**23**	**22**

4. Research

The Sponsored Research Fund accounts for all research transactions, the majority of which are funded externally. The use of these funds is restricted by the sponsor, donor or granting agency and is intended to support the research activities of principal investigators in their areas of expertise. The fund also includes some unrestricted activities funded from internal sources. These activities are typically for start-up purposes or represent residual balances from expired research projects, which are retained by the principal investigators.

Financial Results

There are close to 10,000 active research projects as at December 2016. The vast majority of these projects are restricted in nature. Restricted funds are only recognized as income when the funding received is spent in accordance with the restrictions stipulated by the granting agency so that revenues match expenditures, resulting in a neutral bottom line. For this reason, the research revenues reported in our consolidated statements will vary considerably from the amounts awarded to UBC during any given year. Unrestricted research will have an immediate impact on the reported bottom line each year to the extent the funding has not been spent.

The table below presents the financial forecast for fiscal 2016/17. Management forecasts lower research spending than originally anticipated, which will not impact consolidated surplus.

	Q3 Year to Date			Full Year			2015/16
(in $millions)	Actual	Budget	Variance	Forecast	Budget	Variance	Actual
Revenues							
Government grants and contracts	187	207	(20)	266	318	(51)	283
Non-government grants, contracts and donations	99	97	2	121	87	34	99
Sales and services	2	3	(1)	3	4	(1)	5
Transfers into research	17	15	2	17	20	(3)	28
	305	322	(17)	407	429	(22)	415
Expenses							
Salaries and benefits	173	164	(8)	227	219	(8)	234
Grants and reimbursements to other agencies	25	28	3	34	37	3	32
Operating costs	91	119	28	130	158	28	131
	289	311	22	392	414	22	397
Excess (deficiency) of revenues over expenses	16	11	5	15	15	-	18
Capital Investments	(11)	(8)	(3)	(15)	(15)	-	(9)
Net change in fund balances during the year	5	-	5	-	-	-	9

Awards

The research funding landscape is complex and fast evolving. In the past federal budget, $76M additional funds are to flow this fiscal to the Tri-Council agencies and an additional $19M will be provided for Research Support Fund. As a result, UBC has received more funding from these two programs. Investment in new programs such as the Canada First Research Excellence Fund (CFREF) and significant re-investment in Canada Foundation for Innovation (CFI) is also expected to benefit UBC by more research dollars flowing to researchers.

Over the past few years, we have seen significant decreases in national funding success rates for the Tri-Council programs in particular the Canadian Institutes of Health Research program (CIHR). The university is investing in capacity that helps the institution become more competitive, and early signs are very positive.

In the first three quarters of fiscal year 2017, Tri-Council funding increased in value by 12% compared to the same period in the previous fiscal year. Government and non-profit funding remain steady with only the projected decrease in major new CFI/BCKDF funding this year as large funding competition cycles are held every 2-3 years. During the first 9 months of FY2017, government and not-for profit contracts were up significantly from the three-year average of $55.7 million to $81.8 million. Industry contracts are consistent with the three-year average of $31.2 million at $30.6 million. The total number of Industry contracts for the first 9 months of FY2017 was 1,734.

Below is a summary of research awards projected for fiscal year 2016/17.

Research Award 2016/2017 by Faculty **(In $ Thousands)**	**Government (Tri-Council)**	**Government (Other agencies)**	**Non-Profit**	**Industry**	**Total**
Applied Science	23,757	7,031	6,145	10,070	**47,003**
Arts	15,347	8,027	3,806	142	**27,323**
Dentistry	2,439	591	774	0	**3,805**
Education	3,541	875	1,791	50	**6,257**
Forestry	3,220	3,250	1,404	478	**8,352**
Land and Food Systems	2,371	1,990	1,239	1,624	**7,223**
Law	564	80	277	2	**923**
Medicine	90,588	87,144	106,181	32,384	**316,297**
Pharmaceutical Sciences	1,543	587	1,541	513	**4,183**
Sauder School of Business	2,242	347	518	93	**3,200**
Science	51,947	14,515	17,648	7,607	**91,718**
UBC Okanagan	5,850	2,928	2,881	882	**12,542**
Other Faculties	143	13,834	843	354	**15,175**
Total	**203,550**	**141,200**	**145,050**	**54,200**	**544,000**

5. Endowment

The Endowment funds at the University consist of endowed gifts, bequests, donations and land lease proceeds.

(in $millions)	Total (Including SHFE)		IMANT Invested Funds (excluding TREK)		Land Lease Proceeds (TREK and SHFE)		Others	
Endowment market value	2016/2017 Forecast	2016/2017 Budget (Restated)	2016/2017 Forecast	2016/2017 Budget (Restated)	2016/2017 Forecast	2016/2017 Budget (Restated)	2016/2017 Forecast	2016/2017 Budget (Restated)
Endowment capital account	1,726	1,628	1,038	1,028	511	480	177	120
Stabilization account[1]	205	180	158	141	39	32	8	7
Balance	**1,931**	**1,808**	**1,196**	**1,169**	**550**	**512**	**185**	**127**
Endowment spending								
Investment income[2]	65	62	41	41	21	18	3	3
UBCPT rental distributions	6	6	-	-	6	6	-	-
Operating expenses[3]	(60)	(60)	(37)	(39)	(20)	(18)	(3)	(3)
Surplus (deficit)	**11**	**8**	**4**	**2**	**7**	**6**	**-**	**-**

[1] The stabilization balance reflects the value of endowments that have been generated through returns that are above target levels. It is a measure of how much additional cover is currently contained in the endowment above the core principal balances as protection against future market downturns.

[2] Investment income is recorded using the accrual basis of accounting. For unrestricted endowment funds invesment income includes only realized returns. For restricted endowment funds, investment income includes total returns to the extent of expenses incurred; the excess is deferred and recorded on the Statement of Financial Position until the period in which the related expenses are incurred.

[3] Endowment spending supports the University's academic mission, student financial awards, student housing, academic and research intiatives, as well as capital projects.

Endowment Investments

IMANT Invested Funds

The total market value of IMANT invested funds is forecast to be $1,196m at March 31, 2017. The long-term target rate of return of 6.15% was established to produce a steady income stream to maintain the purchasing power of endowment capital and to support the awards and endowment programs in perpetuity. The rate of return for April to December 2016 was approximately 8%. This favorable variance has resulted in a $3m increase in forecast over budget.

Land Lease Proceeds Endowment (TREK and SHFE)

Prior to 2012, land lease proceeds were directed to the TREK Endowment (an unrestricted endowment, invested by IMANT, to support university priorities). Since 2012, land lease proceeds have been recorded in the Student Housing Financing Endowment (SHFE) to invest in new student residences.

The market value of the land lease proceeds endowment is forecast to be $550m at March 31, 2017, which includes higher land proceeds expected to be received during the year compared to budget.

Other Investments

The forecast for fiscal 2016/17 “other investments” category include:

- Peter Wall Endowment valued at $140m;
- Vancouver Foundation investments, valued at $27m;
- Other donated securities of $12m;
- Merilees Chair, valued at $4m; and
- Promissory notes receivable of $2m.

Figures reported are consistent with market values at December 31, 2016, and differ from budget due to unanticipated donations received and favourable market conditions.