UNDERSTANDING FINANCIAL STATEMENTS
FINANCIAL RATIOS

2018-2019 Edition

The University of Lethbridge's financial statements are prepared following Canadian public sector accounting standards. The annual audited financial statements consist of:

1. Statement of Financial Position

- A "snapshot" of the financial position of the University at the date on the statement (the end date of the fiscal year) that shows the University's ability to cover existing liabilities and endowments, and finance future operations by comparing financial assets to liabilities through the net financial asset (debt) indicator. Secondly, considering non-financial assets, those that are used to deliver services, to determine the University's overall financial position since inception and affordability of future services as the net asset (debt) indicator.
- Can highlight trends in past decision making and funding levels for future operations when excluding endowments held in perpetuity (no fixed end date; must hold indefinitely).

2. Statement of Operations

- Shows income and expenses for the year resulting in an annual operating surplus (deficit) and then considering endowment contributions and related investment income received during the year to determine the annual surplus and accumulated surplus since inception of the University.
- Amounts are recorded using accrual accounting where income is reported when it is received or becomes receivable (e.g. by nature of the terms of a grant agreement) and expenses are reported when ownership is transferred to the University (usually when the goods are received) which may differ from when they are paid.
- Can highlight how well the University is being managed from an operational perspective when comparing to budget, and trends over time to help predict future performance. Budget versus actual is sometimes difficult to assess since budgets generally are prepared on a cash basis and actual includes items such as actuarially determined pension expense (expense recorded based on plan experience not premiums paid).
- The Statement of Operations conforms to Canadian Public Sector Accounting Standards and the expenses are reported by function. The functions are broad categories that report expenses by the major programs of the University (i.e. Academic costs and institutional support, Sponsored research, Ancillary services, etc.). For a breakdown of the expenses by object (i.e. Salaries, Employee benefits, Utilities, etc.) see Note 21 in the Notes to the Financial Statements.

3. Statement of Changes in Net Financial Assets

- Explains the difference between the University's annual operating surplus and the change in net financial assets (debt) during the year.

- Provides information regarding the extent to which expenditures of the fiscal year were met by revenues recognized in the year.
- Can highlight where additions or uses of financial assets, or new or retired liabilities, have contributed to the net financial asset indicator for the year.

4. Statement of Remeasurement Gains and Losses

- Shows the unrealized change in the value of financial instruments, such as investments, being measured at fair market value at the Statement of Financial Position date as well as the year end conversion of balances held in foreign currency, such as payables.
- The unrealized (fair value) amounts are only recorded in the Statement of Operations when the financial instrument is sold or settled.

5. Statement of Cash Flows

- Shows the cash generated or used between the University and outside entities over the year, grouped in four main categories: operating, investing, financing, and capital.
- Can highlight trends in cash flow and the cash available to operate.

6. Notes to the Financial Statements

- Detailed description of the accounting policies used by the University and additional information for significant figures in the financial statements.
- Provides additional information to help users understand the results and make projections on future operations.

1. STATEMENT OF FINANCIAL POSITION

The Statement of Financial Position includes:

- Financial assets
  - Assets that could be used to discharge existing liabilities or finance future operations.
  - Examples include cash, accounts receivable and non-endowment investments.
  - Non-endowment investments include unrestricted surpluses, internally restricted surplus and deferred revenue from restricted research, trust and capital grants and funds not yet spent.
- Liabilities
  - Present obligations or amounts received and not yet earned.
  - Accounts payable and accrued liabilities are obligations owed at the yearend date, or the expense relates to the current period but is not yet invoiced or due.
  - Employee future benefit liabilities include pension plan liabilities, long-term disabilities accruals, early retirement plans, and senior administrative leaves.
  - Debt includes loan obligations due in future periods.
  - Deferred revenue includes tuition revenue collected but not earned and unspent externally restricted grants and donations that have been received but have not been spent for the intended purpose as of the year end date.
- Portfolio investments – restricted for endowments
  - Amount of investments held in perpetuity (no fixed end date; must hold indefinitely) for purposes stipulated by donors, such as awarding annual scholarships and funding academic programs.
- Non-financial assets
  - Assets acquired, constructed or spent to deliver services, are consumed in normal operations and are not held for sale.
  - Examples include tangible capital assets, prepaid expenses and inventories to be used in delivering services.
  - Tangible capital assets consist of land, buildings, equipment, and library resources. All assets over $5,000, and land of any value, are capitalized and amortized over their useful lives. Amortizing is an accrual accounting transaction to record a portion of the cost of an asset as an expense in each year the asset is expected to be in service (essentially the cost of using that asset for the year).
- Spent deferred capital contributions
  - Grants and donations received for, and spent on, capital acquisitions where the conditions of the grant and the University's actions and commitments create a liability.

- Grants and donations received for capital acquisitions are recorded as revenue in the statement of operations by revenue source in the same manner as the capital assets funded by them are amortized. For example, if the university received a Government of Alberta grant of $120,000 for a building, which was being amortized to expense over an estimated 40 years' service life, the university would recognize $3,000 of Government of Alberta revenue per year in the statement of operations ($120,000/40 years) for 40 years.

- Net Assets is the residual value of financial assets, portfolio investments restricted for endowments and non-financial assets less liabilities and spent deferred capital contributions.
  - Accumulated surplus includes:
    - Accumulated surplus from operations - the University's income or losses since inception less the amount internally restricted. The University's Carryover Fund policy directs how unrestricted surplus is spent and it consists primarily of the balances of unspent annual budgets.
    - Investment in tangible capital assets - the amount the University has spent on capital assets less amortization, debt and spent deferred capital contributions.
    - Internally restricted surplus – the amount set aside for specific projects such as funding strategic priorities, one-time expenditures for increasing efficiency, reducing costs, and construction projects.
    - Endowments - consists of donations/contributions and investment income earned on investments that must be maintained in perpetuity.
  - Accumulated remeasurement gains and losses consist of gains and losses of statement of financial position balances being recorded at their fair value or converted to Canadian currency, which have not been realized through actual transactions.

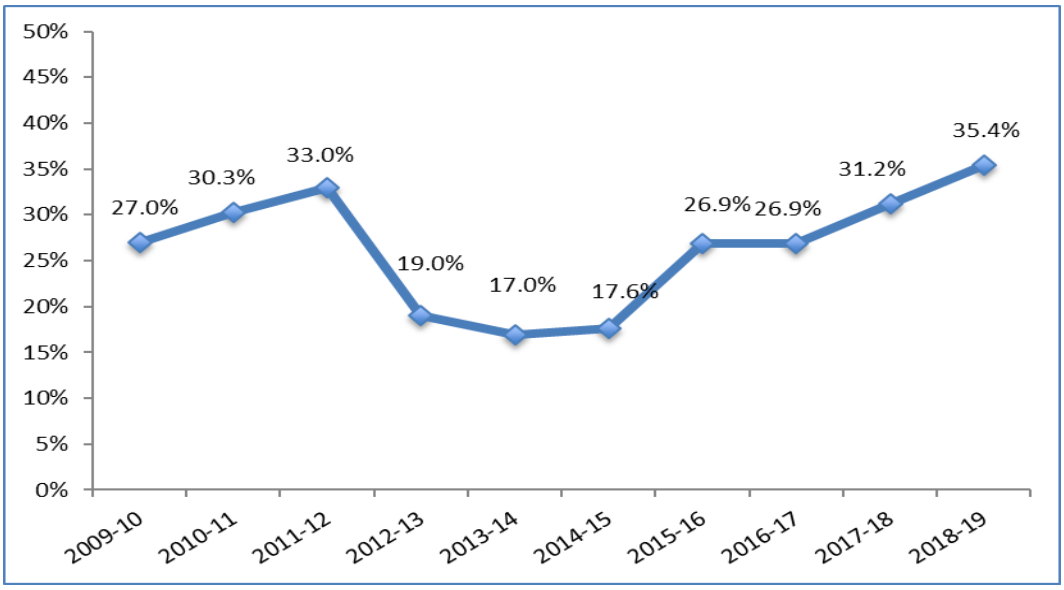
Financial Position Ratio Analysis

Primary Reserve Ratio

- Measures the financial strength of the institution by comparing expendable net assets to total unrestricted expenses.
- Unrestricted net assets represent assets that the University has unrestricted access to and spend to satisfy its obligations.
- Can indicate how long the institution could function using its expendable reserves without relying on additional net assets generated by operations, or indicate amounts available to fund future strategic priorities.
- A negative ratio or decreasing trend indicates a weakening financial condition and the use of reserves for strategic priorities or other purposes.

Primary Reserve Ratio = $\frac{\textit{Accumulated surplus from operations + internally restricted surplus}}{\textit{Total Unrestricted Expenses}}$

2018-19 = $66,957 / $189,040 = 35.4%



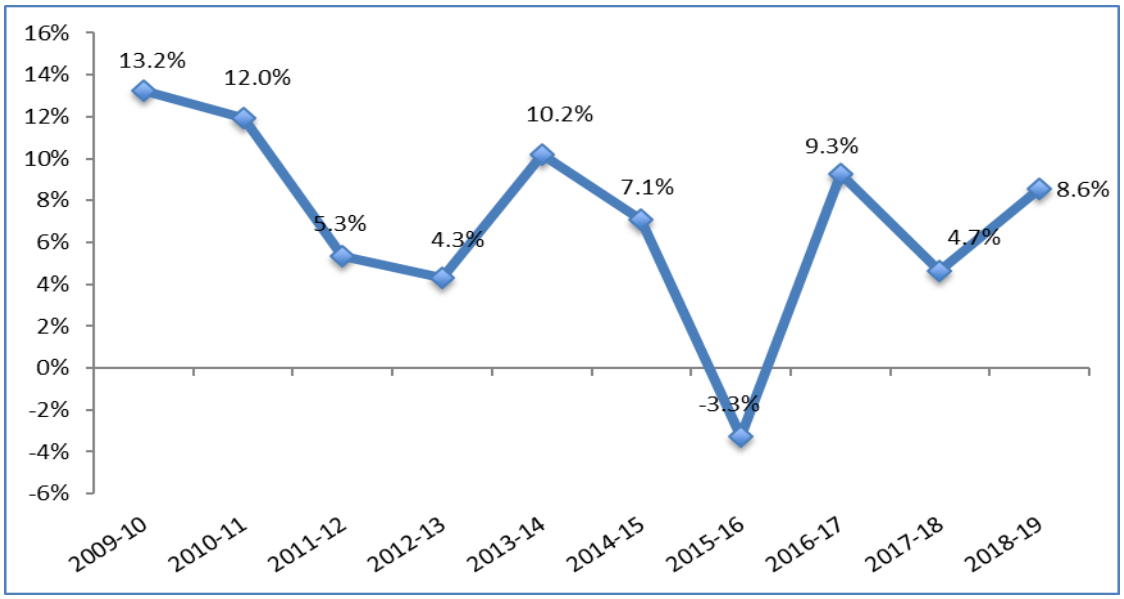
- The University's primary reserve ratio indicates the financial condition is healthy. The upward trend in this ratio is intentional. There are significant costs associated with the opening of the new Science and Academic building (Science Commons) and there was a $20 million University commitment to the construction of the building either from fund raising and/or internal contributions. In 2019- 20 this ratio is expected to decline as the Science Commons construction project will be finished, and funds will have been spent. It is also anticipated that there will be an actuarial Universities Academic Pension Plan (UAPP) loss in 2019/20 due to lower than average investment earnings in the Plan in 2018.
- The 2018-19 increase in the ratio is primarily due to the recognition of an actuarial gain in the UAPP of $4.3 million and the receipt of insurance proceeds of $1 million for past claims.
- The ratio decreased in 2012-13 due to the use of reserve funds for strategic priorities, the largest expense relating to the construction of a new student residence.
- The spike in 2015-16 was a result of realizing $12.5 million in investment income as a result of changing investment managers and products. Removing that unusual event, the primary reserve ratio would have been 20%, and consistent with the prior 4 year trend.

Return on Net Assets Ratio

- Determines whether the institution is financially better off than in previous years by measuring total economic return.
- An improvement in this ratio indicates that the institution is increasing its net assets and is likely to be able to set aside financial resources to strengthen its future financial flexibility.
- A temporary decline in this ratio may be appropriate if it reflects a strategy to better fulfill the University's strategic mission.

$$\textit{Return on Net Assets} = \frac{\textit{Change in net assets}}{\textit{Total net assets (beginning of year)}}$$

2018-19 = $20,249 / $235,886 = 8.6%



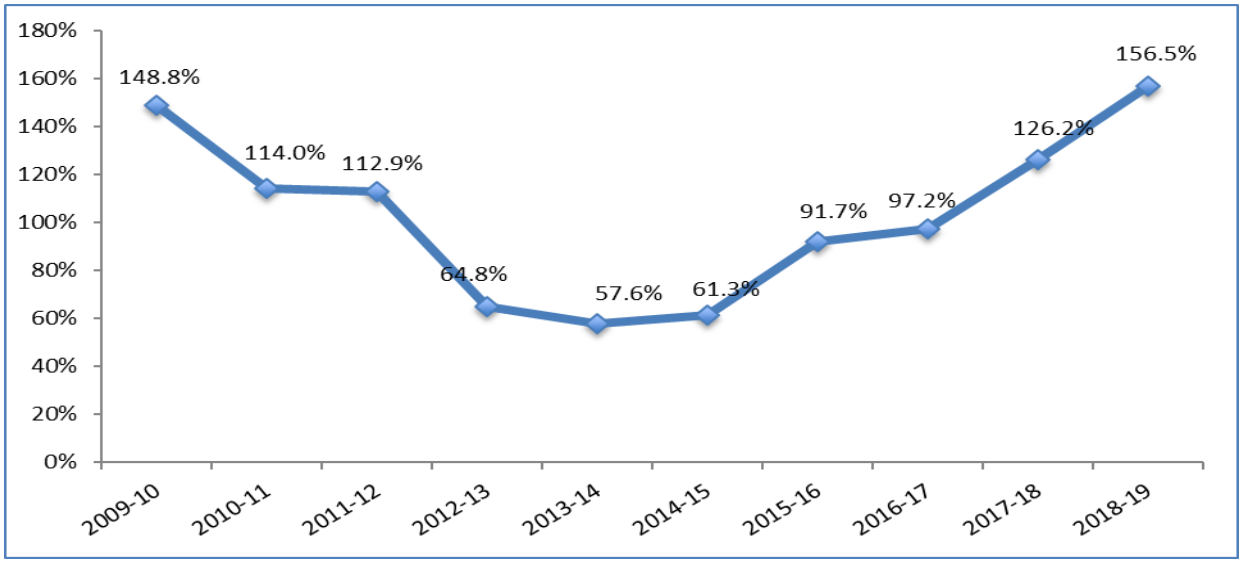
- The dip in 2015-16 is mainly the result of the drop in unrealized gains and losses shown in accumulated remeasurement gains and losses due to investment income being realized on the sale of investments to transition to new investment managers and products.
- The 2018-19 increase in the ratio is primarily due to the recognition of an actuarial gain in the UAPP of $4.3 million and the receipt of insurance proceeds of $1 million for past claims.

Viability Ratio

- Measures the availability of expendable net assets to cover debt should the institution need to settle its obligations immediately.
- If the viability ratio falls below 1:1 the institution's ability to respond to adverse conditions diminishes.
- Debt includes borrowed money, as well as long-term obligations for staff benefits, including early retirement obligations and accrued benefit plans.

Viability Ratio = $\frac{\text{Unrestricted Net Assets}}{\text{Long-term debt}}$

2018-19 = $66,957 / $42,772 = 156.5%



- The increases since 2015-16 are mainly due to investment income earned on the sale of investments in the transition to new investment managers and products (2015-16) and a reduction in the actuarially determined UAPP unfunded liability in the last four years.

2. STATEMENT OF OPERATIONS

- While the Statement of Financial Position shows the accumulated balances since inception, the Statement of Operations shows the annual operating surplus (loss) resulting from the year's operating revenues and expenses, the annual surplus when including endowment contributions, and finally the University's accumulated surplus since inception.
- A question often raised is "So what does the operating surplus (loss) tell me? Is it how much cash is available to spend?" This is not the case as the annual operating surplus (loss) includes the accrual of non-cash items such as amortization of capital assets, capital contributions, and an actuarially determined amount for pension expense and other long term employee future benefits. Instead, the accumulated operating surplus answers the question " how much did it cost to run the University's operations during the year, and in turn did we have enough revenues this year to cover them?" The annual operating surplus also does not take into account any funds that the Board of Governors has set aside to fund strategic priorities. The accumulated surplus from operations portion of net assets (Financial Statement Note 13) is a better indicator of the funds available to the University which have not been specifically designated for a purpose, although it includes the unrealized remeasurement gains and losses from non-endowment purposes which have not been realized through actual transactions, and is net of the $20.1 million unfunded Universities Academic Pension Plan liability.

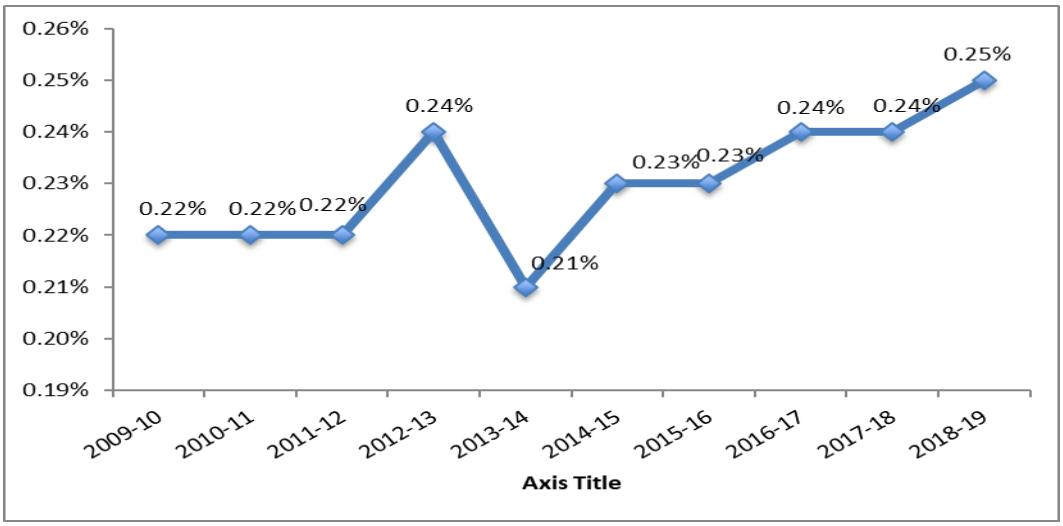
Analysis of the Statement of Operations using ratios:

Debt Burden Ratio

- Measures the institutions dependence on borrowed funds as a source of financing and the cost of borrowing relative to overall expenditures.

$$\textit{Debt Burden Ratio} = \frac{\textit{Debt Service (principal \& interest)}}{\textit{Total Expenditures (less amortization)}}$$

2018-19 = $487 / $192,680 = 0.25%



- The University holds relatively small, long term mortgages on its student residences which do

not require significant repayments annually, resulting in the debt burden ratio being so low.

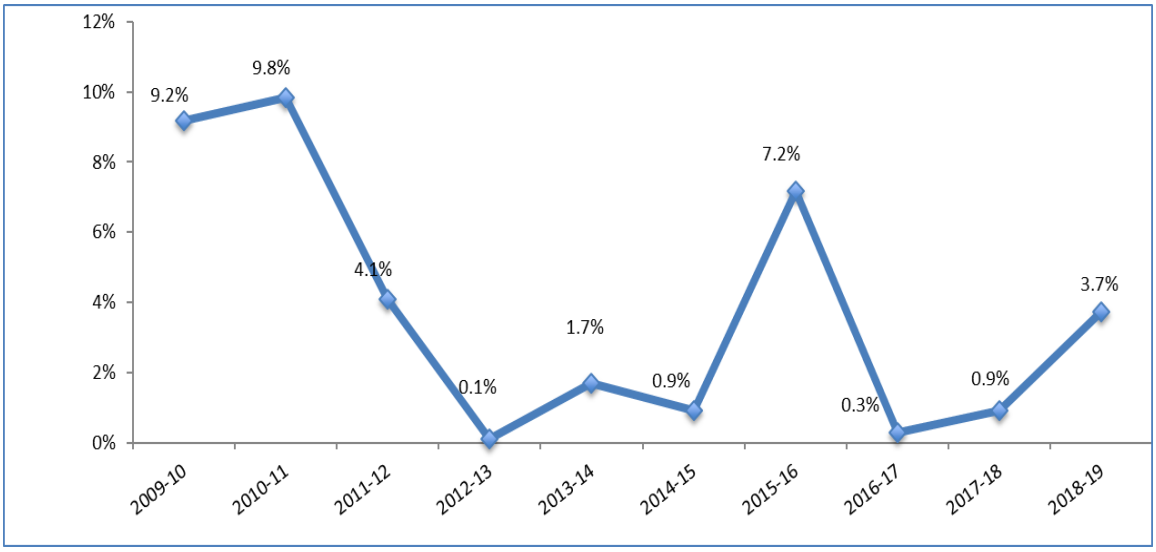
- The current debt will be fully repaid in 2037.

Net Operating Revenues Ratio

- Indicates whether total operating activities resulted in a surplus or deficit, and thus, whether the institution is living within available resources.
- A positive ratio indicates that the University has an operating surplus for the year.

$$\textit{Net Operating Revenues Ratio} = \frac{\textit{Unrestricted Operating Income (loss)}}{\textit{Unrestricted Operating Revenues}}$$

2018-19 = $7,307 / $196,347 = 3.7%



- The decrease in 2012-13 was primarily due to the increase in employee future benefit expenses resulting from recording of academic voluntary retirement program payouts and the removal of unrealized gains on losses from the statement of operations required with the transition to public sector accounting standards.
- The increase in 2015-16 is primarily due to investment income ($12.5 million) earned on the sale of investments to transition to new investment managers and products. Without this unusual, one-time event the net operating revenue ratio would be 0.8% and maintain the trend experienced over the last six years.
- The increase in 2018-19 is primarily due to a lower actuarial pension expense for UAPP than expected due to better plan experience than expected and the amortization of a significant actuarial gain ($4.3 million) from the prior year.

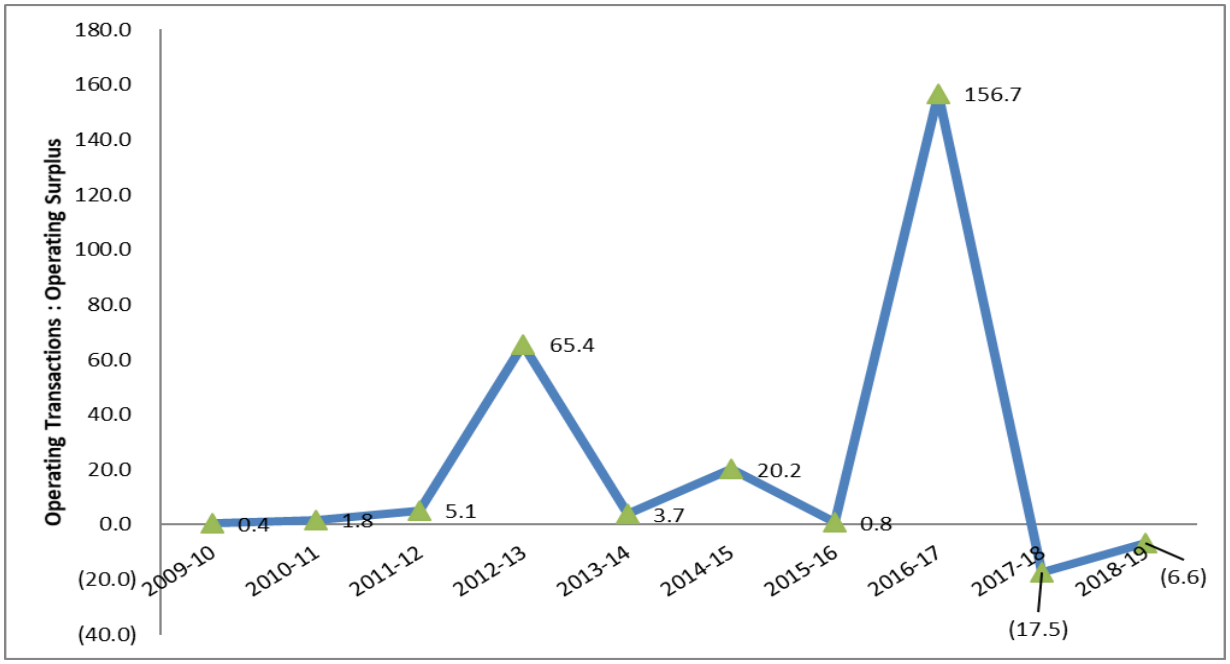
3. STATEMENT OF CASH FLOWS

- Cash flow statements report the inflows and outflows of cash and shows if cash was generated (positives) or used (negatives) during the fiscal year. This is important because it shows which activities used or added cash, and assists in understanding the type of cash needs going forward.

  Operating Transactions:

  - This section of the cash flow statement reconciles the annual operating surplus (Statement of Operations) to the actual cash the University received from or used in its operating activities. All non-cash items are eliminated (e.g. amortization, investment gains reinvested) along with any cash that was used or provided by other operating assets and liabilities.
  - If comparing the total operating transactions to operating surplus on the Statement of Operations results in a positive amount, then revenues being recorded are turning into cash for operating the University.

2018-19 Operating Activities / Operating Surplus = $(48,311) / $7,308 = (6.6)%



  - The spike in 2012-13 was mainly due to an increase in employee future benefit liabilities resulting from recording academic voluntary retirement program payouts.
  - The large increase in 2016-17 is due to an increase in deferred revenue and spent deferred capital contributions relating to the new science and academic building project (Science Commons) grant received of $125 million grant.
  - The sharp decline in 2017-18 resulted by decreasing the deferred revenue as we spent the funds received for the new science and academic building construction project.

  Investing Transactions:

- Includes purchases and sales of portfolio investments.
- If the University sold investments from its investment portfolio, the proceeds from the sales would be shown as a cash inflow from investing activities because it provided cash to the University. It is the University's practice to reinvestment investment earnings and proceeds of sales, which are shown as a cash outflow.

Financing Transactions:

- Typical sources of cash flow for financing activities include cash provided through new debt and cash received from external sources to finance capital transactions.
- Long term debt payments (i.e. mortgage payments) would be reflected as a use of cash flow, while securing a new loan would be reflected as an inflow of cash. When external funds are spent on capital purchases or construction, they are reflected as cash inflows, while the recognition of these funds over the life of the asset to the statement of operations will be shown as cash outflows.
- A positive balance indicates cash was added through new loans, or more external capital funds have been spent than we repaid or recognized. A negative balance indicates we have repaid more debt or recognized more external funds over the life of the assets than new debt or external funds have been received and used.

Capital Transactions:

- Capital activities indicate the additions, or use of cash, and sales, inflow of cash, for tangible capital assets that occurred during the year.