4. Budget Report, 2003–04

Professor Neuman spoke to the 2003-04 Budget Report with the assistance of a powerpoint presentation (attached hereto as Appendix "A"). The University was at the end of a six-year planning period where, by direction of the Governing Council, it was required to present a balanced annual budget, with an accumulated deficit of no more than 1.5% of the operating budget. In absolute terms, the latter condition meant that by April 30, 2004 the accumulated deficit could not exceed \$14.7 million. To provide further context to the report, she reported that the projected accumulative deficit of \$20.3 million for the end of 2002-03 had to be adjusted, when actual year-end results for 2001-02 were known, to \$22.4 million. At this time, the deficit for 2002-03 appeared to be evolving to worse than projected and was now anticipated to be \$34.1 million by April 30, 2003. This had come about mainly as a result of unrealized operating and investment revenue. There were also higher than predicted expenses, primarily related to costs for natural gas and for asbestos removal.

Revised revenue and expense assumptions for 2003-04 provided for an increase of \$4.4 million in the amortization of investment losses. The amended investment policy approved in this meeting should allow for investment decisions that would lead to more stability in revenue from investment income. Contributions to the pension plan would need to commence a year earlier than anticipated. For a number of years the University had been prohibited by federal law from making contributions to the pension plan because the plan's surplus had exceeded the allowable limit. Seventy-five percent of the pension contribution savings had been retained annually in the budget and used for one-time-only expenditures, such as matching funds for endowed chairs, the voluntary early retirement plan implemented to meet budget cuts at the end of the 90's, and to fund the University Infrastructure Investment Fund. Twenty-five percent of the pension contribution savings dropped to the bottom line. In 2003-04, the University would no longer be able to use the 75% set aside from pension contributions to meet one-time-only expenses. It had been anticipated that this adjustment, including adding the remaining 25%, would be necessary in 2004-05 and that it could be phased in. Because of depletion of the pension plan surplus as a result of poor market performance and increased benefits, the period of pension contribution savings would end earlier and more abruptly than planned. It now seemed likely that the pension plan would be in a market and actuarial deficit by July 1, 2004.

Professor Neuman pointed out that the inflation adjustment of 2% on government operating grants would no longer be assumed. This had been kept in the budget during the past six years as a continuing focus of discussion with the Government. In previous years, other sources of revenue had made up for this unrealized revenue. This year, those sources were not available. In its budget on March 27, the Government had announced quality assurance funding, which would address, to some degree, the erosion in the operating grant from inflation, and Professor Neuman would speak to the effect of that later. She also noted the elimination of \$6.2 million previously assumed as the increase from 20% to 30% in grants for indirect costs of federally funded research.

Looking at major revenue assumptions, Professor Neuman recalled the zero increase in grants for general inflationary purposes in 2003-04. Tuition fee revenue from the majority of students would remain capped by the Ministry of Training Colleges and Universities (MTCU) at 1.9 %, which, when stripped of the 30% holdback on the increase assigned to student financial aid, became 1.3%. When adjusted for inflation, this percentage was reduced further. Investment revenue had been reduced by a further \$2.4 million and past losses would be amortized over five years. The University expected full average funding for enrolment growth in undergraduate programs and assumed an

MTCU imposed cap on graduate enrolment growth funding. Revenue of an additional $17.1 million in grants and fees was assumed over that previously budgeted. This was largely volume-driven. Indirect cost recovery of federally funded research was projected to be $15.8 million, assuming a 20% rate. The endowment payout would reduce to 4.2% of the November 2, 2003 market value, from 5%. Finally, $2.5 million had been provided in the operating budget to assist those units who would have the most difficulty in the transition to the lower pay-out, for example in those divisions where the endowment payout covered fixed costs. The budgeted amount was not sufficient to meet the entire shortfall.

Income from provincial operating grants would increase from $391.2 million to $412.9 million. This was almost entirely volume-related since the value of the basic operating grant per basic income unit (BIU) had increased hardly at all. The increase in revenue of $47.6 million from tuition fees was a combination of mostly volume and some increased tuition. Looking at total operating revenue and comparing from 1998-99 to what was projected for 2003-04, the dramatic increase was attributable to tuition fees and other sources.

Professor Neuman pointed out that the basic operating grant per BIU had been $4,419 in 1991-92, had dropped to a low of $3,176 in 1996-97 and, at $3,699 in 2002-03, was actually still $700 less per student than it was 12 years ago. When this was adjusted for inflation, the University was, in fact, receiving $1,600 less per student from provincial operating grants than it had in 1991-92. Therein was a significant source of ongoing financial difficulty.

In comparisons with other Canadian provinces Ontario was by far the most poorly funded by operating grants. The University of Toronto Arts and Science tuition and other fees were among the lowest in comparisons with other AAU peer institutions. Looking at statistics comparing the University of Toronto with AAU peer institutions in state appropriations plus fees, Toronto was the lowest and significantly lower than the peer group average.

Professor Neuman expanded briefly on several of the major cost drivers of the 2003-04 budget. The Library acquisitions fund was a significant item but one of the more important, so as to ensure that the Robarts Library remained in the top three to five private and public libraries in North America and to preserve its function as a critical support to teaching and research for the entire University community. This Library had been and continued to be a major source of support for research to universities across the country and the budgetary support it had received over the years was a great tribute to the wise planning at the University of Toronto.

Professor Neuman noted that for many years the University had not had a capital budget. The one presented as part of this Budget Report had evolved from the University Infrastructure Investment Fund (UIIF). It comprised projected numbers rather than commitments and should be viewed as very much a work in progress. The debt service charge of $11.7 million in 2003-04, which subsumed $8.9 million of annual principal and interest charges on borrowing to fund the UIIF and the University's contribution to MARS, was included as an expense in the operating budget.

Finally, Professor Neuman recalled that the guaranteed funding packages for doctoral-stream students was to be fully implemented by September 2003, though she was not certain that it would be possible to achieve that objective this year with the students in programs at the Ontario Institute for Studies in Education (OISE). The major financial commitment to this very important program had been made during this past year and all reports from the divisions indicated that the initiative was achieving its objective of attracting top students.

Professor Neuman noted that the proposed budget reduction of 4.45% would amount to $22.2 million and would allow the University to meet its objective of a balanced operating budget for 2003-04. The budget projection anticipated an April 30, 2004 surplus of $19.4 million. Members might wonder why, in a very difficult year, the budget was projecting an in-year surplus. Professor Neuman explained that, with a start-of-year deficit of $34 million, this would enable the University to reach the end of year with a cumulative deficit of no more than 1.5% of operating budget -- $100,000 under the level permitted by Governing Council guidelines.

Professor Neuman identified financial challenges beyond 2003-04 related to pension plan contributions, the growing need to fund deferred maintenance, funding for initiatives evolving out of the new academic planning process, and the considerable costs for capital expansion together with the operating costs accompanying additional space. If, as projected, the pension plan was in an actuarial deficit by July 2004, the University would be required to pay the full current service costs, $9.4 million in 2004-05 over the cost for 2003-04, and make up the actuarial deficit, unless there were a significant improvement in the market conditions. Professor Neuman noted that the Business Board would hear a full report on deferred maintenance later in the meeting, but reviewed briefly the extent of what was identified as a $276 million problem. Nine million dollars in base funding was required to hold the line on deferred maintenance and to improve routine maintenance operations.

Following the presentation of the Budget Report to the Planning and Budget Committee, the Provincial Budget had announced increased revenue to universities. Quality Assurance Funds of $75 million in 2003-04, rising to $200 million in 2006-07, were expected to mean $15 million additional funding to the University of Toronto in the upcoming year if the funding was allocated on a pro-rata manner. However, an issue had arisen with the indirect costs of research, namely, the University had attributed last year's allocation to 2001-02. The Government's understanding was that the base allocation was to be attributed to 2003-04, leaving us with a gap in 2002-03. The University was still in discussion with the Government on this matter. The OTO budget cut of 1.46% could likely be eliminated by the Provincial grant increase even if there was a gap year in the delivery of the Indirect Cost of Federal Research funding.

In summary, Professor Neuman believed that this was a fiscally prudent budget. Some members of governance had asked why the administration had not requested the Governing Council to raise the limit on the end-of-cycle deficit. This might seem justifiable in light of the unforeseen circumstances that had caused the revenue difficulties and the continuing hope that the Provincial Government would move to inflation-adjusted operating grants. The administration had not made this request because they believed it would have been unwise to avoid dealing with the deficit this year. This caution was related to the probability of a gap-year in the base funding of the Indirect Costs of Research and to the deficit situation of the pension plan. To meet the liabilities of the plan, there needed to be a 6.5% to 7% return on investment annually. With the growing gap between the reduced return on investment and the increasing liabilities, this was presenting a challenge for which a solution was being developed. In this context, it would not be prudent to delay addressing the budget deficit.

Professor Neuman closed her presentation with a review of what could be expected to be the net changes to divisional budgets. These totaled $39.3 million but, if the Quality Assurance Funding came through as expected, the total net increase to divisional budgets would likely rise to $46.6 million, with elimination of the need for OTO deficit control measures.

Prior to beginning debate, the Chair reminded members that the Business Board was asked to concur with the recommendation of the Academic Board that the Budget Report be approved. The concurrence would indicate the Board's view that the Budget was a financially responsible one. The Board's focus and duty was to satisfy itself that the bottom line was acceptable, that the assumptions were realistic and that the level of risk was prudent.

The President expressed his view that the policy revisions that had been undertaken with respect to revenue from investment performance (for example, the adjustments related to the endowment payout) would reduce vulnerability to swings in the market.

The President spoke briefly about the positive news in the Provincial budget, thanking Dr. Levy for his consistent and effective lobbying of the Provincial Government and recognizing Dr. Mordecai Rozanski, Chair of the Council of Ontario Universities and President of the University of Guelph, and Dr. Ian Clark, President of the Council of Ontario Universities, for achieving the objective of increased funding that, hopefully, would translate into $40 million per year for the University of Toronto by 2006-07.

The President noted that, although the budget made no assumptions for the next year about increased funding for indirect costs of federally funded research, he was optimistic that the percentage would eventually go up to 30% as had been anticipated.

In closing, the President acknowledged that these had been very difficult circumstances in which to bring together a budget and he applauded Professor Neuman, Professor McCammond and the staff in the Planning and Budget Office for a job well done. Professor Neuman added that it was with great regret that she informed the Board that this would be the last budget prepared by Professor McCammond before he stepped down as Vice-Provost, Planning and Budget. The quality of the Budget Report before the Board spoke to the great integrity with which Professor McCammond carried out his responsibilities, and his assistance and advice would be greatly missed.

Several members expressed their appreciation to the Provost for an excellent Budget Report. They applauded the quality of the Report, the clarity with which it was presented; the transparency of the risks; and, in particular, the reversal of the trend in which operating expenditures were greater than revenue. A member asked for an explanation of the three line items related to pension contributions in the slide depicting the Long Range Budget Projection from 1998-99 to 2003-04. Professor Neuman replied that the first item of $21.2 million was what had been projected to be Pension Contribution Savings in 2003-04. The second amount, $18.8 million, represented what had to be used of that amount to meet the pension service cost for 2003-04, an expenditure that, in long-range planning, had not been expected to occur until 2004-05. The third, $19.7 million, represented pension savings that had been directed to the UIIF in the past and now, because these funds were required for pension service costs, were included in the debt to be serviced in the Capital Budget.

A member expressed some concern over the plan to amortize investment losses over the next five years. Was it the most prudent course of action and were the University's auditors in agreement that this was acceptable accounting practice? Professor Neuman replied that the amortization of Expendable Fund Investment Pool (EFIP) losses was acceptable only with the concurrent changes in investment policy that ensured stability in investment return. While this may not be the most conservative nor prudent approach, the University was left with no choice. It would be unable to meet its obligation to provide quality programming to its students if it were to absorb these losses in a shorter period of time. Mr. Chee added that this had been discussed with the University's auditors.

A member asked what effect the 4.45% budget cut might have on jobs and programs. Professor Neuman indicated that these were decisions that were made in the divisions. However, given that the turnover in administrative staff was fairly constant in an institution this large, it was usually the case that an individual, whose job was lost due to organizational change resulting from a reduction in divisional operating budget, would be able to find employment in another division.

A member expressed great satisfaction that there was to be funding within the next budget plan to begin addressing deferred maintenance. This was a high priority in his view and warranted a tough look at justifying academic programs. Professor Neuman agreed that the problem was critical, but said that its magnitude required that funding had to be found from sources outside of the operating budget. With respect to program justification, she thought that this was a decision that would happen within divisions as they saw the need for it.

On motion duly moved and seconded,

YOUR BOARD CONCURS WITH THE PROSPECTIVE RECOMMENDATION OF THE ACADEMIC BOARD

THAT the Budget Report, 2003-04, be approved.