McMaster University Annual Financial Report ■ 2006/07

McMaster
University

Measuring our Performance

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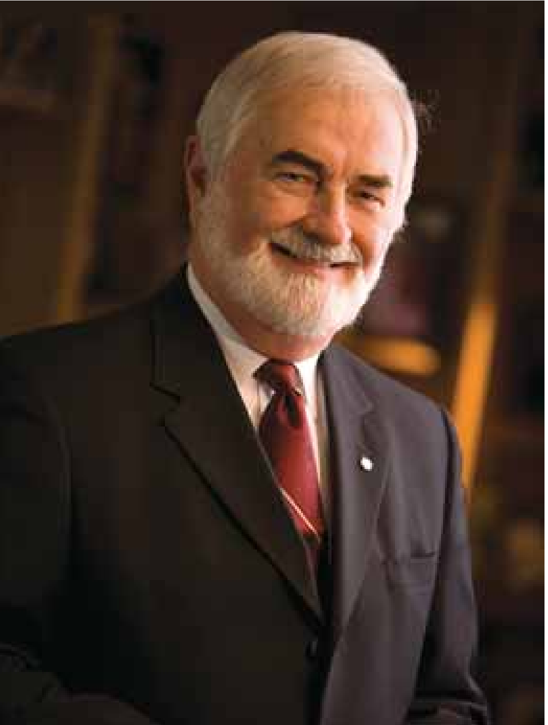
Management Discussion and Analysis[1]

1 This commentary includes future-oriented financial information and commentary ("FOFI") which may involve, but are not limited to, comments with respect to the University's future objectives, strategies, targets or results. Readers are cautioned as to undue reliance on the FOFI as a number of factors could cause actual results to differ from the expectations or intentions expressed in the FOFI. Future outcomes may be influenced by many factors, including but not limited to the critical risks identified by the University's Enterprise Wide Risk Management program. This commentary was prepared in accordance with the Canadian Institute of Chartered Accountants' Guidance on Preparation and Disclosure of Mangagement's Discussion and Analysis.



Peter George
President and Vice-Chancellor, McMaster University

Measuring our Performance—2006/07
Executive Summary

At McMaster University we share a vision: to be among the best in the world. It is a goal that has served us well and taken us far. Since our founding 120 years ago, McMaster has built a reputation for academic and research excellence and has become internationally renowned for innovative approaches to teaching and learning. McMaster's pioneering efforts have introduced revolutionary concepts such as problem-based learning and evidence-based medicine leaving a lasting legacy.[2]

In 2006/07, the University achieved many successes and achievements that move us toward our goal. But there is no shortage of challenges. As a publicly funded institution, we have limits to our control over revenues and fee setting autonomy. We balance this risk by demonstrating excellence in academic programs and research results that enable us to foster strong relationships with donors, industry leaders and other leading academic partners nationally and internationally.

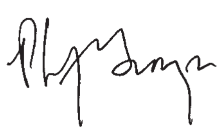
We are committed to creativity, innovation and excellence. We value integrity, quality, inclusiveness and teamwork in everything we do.

SUCCESSES AND CHALLENGES

Successes
- met enrolment targets and increased entering average
- set a three year plan to eliminate the operating deficit
- ranked 1st in Canada for research intensity
- achieved tremendous fundraising success
- implemented teaching-stream faculty rank
- expanded programs regionally and internationally
- achieved strong growth of endowments

Challenges
- increased inflationary costs out pace new revenues
- increased provincial funding uncertainty
- increased dependence on one-time funding
- reduced operating net assets available to re-invest
- increases in debt financing to meet space needs
- increased student faculty ratios and class sizes
- increasing cost of future employee benefits

HIGHLIGHTS AT A GLANCE	2006/07	2005/06	%inc/(decr)
Enrolment (Full Time Equivalent (FTE))	22,903	22,140	3.4%
% of level 1 students with an entering grade > 80%	73.7%	69.7%	5.7%
Total Net Assets ($ millions)	693.3	628.7	10.3%
Operating Net Assets ($ millions)	71.0	85.3	(16.7%)
Endowment per FTE student ($)	21,800	20,300	7.3%
Total Revenue per FTE student ($)	31,900	31,000	3.0%



Peter George

2 Learning without Boundaries, 2007

Mission, Vision and Strategy

Mission

At McMaster our purpose is the discovery, communication and preservation of knowledge. In our teaching, research and scholarship, we are committed to creativity, innovation and excellence. We value integrity, quality, inclusiveness and teamwork in everything we do. We inspire critical thinking, personal growth, and a passion for lifelong learning. We serve the social, cultural and economic needs of our community and our society.

Vision

To achieve international distinction for creativity, innovation and excellence.

Strategy – Refining Directions

The *Refining Directions* strategic planning exercise was launched in 2002 with the dual objectives to evaluate the University's success in meeting the goals established in the 1995 Directions strategic plan and to construct a strategic framework to guide the University's course for the next five to ten years.

Through the extensive *Refining Directions* consultation process there was wide-spread satisfaction with the mission and vision. In 2003, the Board of Governors reaffirmed the mission and vision as set out in Directions and confirmed the University's strategic position as a student-centered, research-intensive university. To achieve the mission, the Board of Governors has approved the *Refining Directions* framework that identifies three strategic goals with broad institutional targets:

- to provide an innovative and stimulating learning environment where students can prepare themselves to excel in life
- to achieve the next level in research results and reputation by building on existing and emerging areas of excellence
- to build an inclusive community with a shared purpose

Financial Management

At the institution level, the University has implemented a planning, budgeting and management control system governed by the University Planning Committee ("UPC"). The goals are to integrate academic, strategic and financial planning institution-wide and to ensure fiscal accountability at all levels through aligning resources and management responsibilities. At McMaster, operational responsibility is vested with the budget envelope managers and detailed implementation strategies are developed and executed at the Faculty and business unit level. The UPC, therefore, has overall responsibility for implementing *Refining Directions*.

To achieve the academic mission a strong financial position is required. The University has identified four key financial performance goals:

- to achieve strong demand for programs and consistently achieve student enrolment targets
- to increase and diversify the revenue base
- to strategically deploy resources into priority areas
- to strengthen its financial position and manage business risks

The University measures its success in achieving the financial performance goals through the review of key financial indicators. The actual results are analysed in the context of the goals to provide an understanding of the University's strengths and the challenges it faces in executing its financial strategies.

Looking forward, all of the diligent attention to planning can be severely discounted by the high degree of uncertainty with respect to government funding. As a result, the University's planning is balanced by a risk management approach intended to decrease budget variances and increase fiscal certainty.

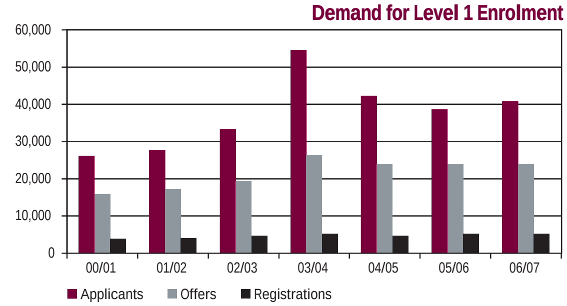
Finding new ways to balance the budget remains a top priority. The 2007/08 budget was recently approved by the Board of Governors and is part of a three year financial plan that will achieve its 2009/10 objective of eliminating the in-year operating deficit within this timeframe. This plan respects the fiscal challenges while investing in strategies that further the achievement of the *Refining Directions* goals.

2006/07 Key Financial Indicators

Achieve Strong Demand for Programs

- 5.7% increase in Level 1 applications was similar to the provincial increase
- the proportion of students naming McMaster as their first choice increased by 12.4%
- the percentage of students who accepted McMaster offers remained consistent at 22.1% (2005/06-22.0%)

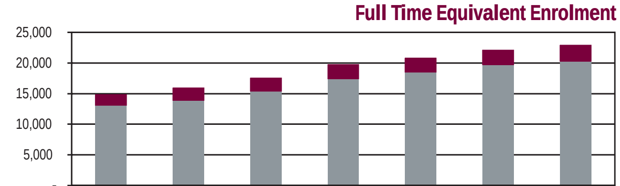
Demand for Level 1 Enrolment



Achieve Targeted Enrolment Levels

- 3.4% annual increase in total full time equivalent (FTE) enrolment to 22,903 FTE's
- FTE enrolment is ahead of target by 0.6%
- 2.9% growth in undergraduate enrolment, and an 8.0% increase in graduate enrolment

Full Time Equivalent Enrolment

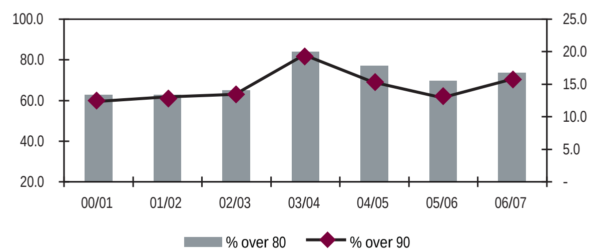


	00/01	01/02	02/03	03/04	04/05	05/06	06/07
Graduate	1,805	2,035	2,185	2,389	2,344	2,439	2,634
Undergraduate	13,054	13,895	15,406	17,388	18,463	19,701	20,269

Attract Students with High Academic Standing

- average entering grade increased to 83.5% (2005/06-82.9%)
- % of Level 1 students with an entering average greater than 80, increased to 73.7% (2005/06-69.7%)
- % of Level 1 students with an entering average greater than 90% increased to 15.5% (2005/06-12.7%)

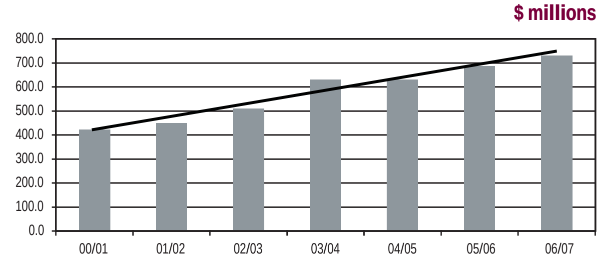
Student Quality
% of Level 1 Students by Entering Grade



Increase the Revenue Base

- $45.6 million (6.7%) increase in total revenue reflects increased student enrolment and strong growth in operating grants, donations, and other grants
- revenue has grown by 83% over the past six years to $731 million
- revenue per FTE at $31,900 is a modest 3.0% increase over 2005/06

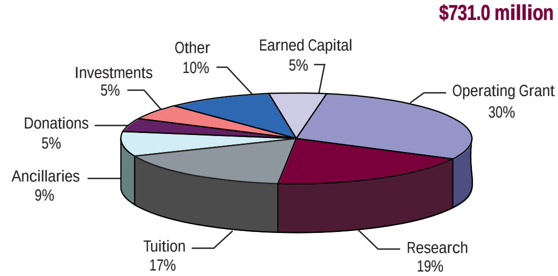
Total Revenue
$ millions



Diversify the Revenue Base

- well-diversified revenue base reduces dependency on any one source
- % of revenue received from operating grants increased as a result of significant one-time year end grants from the Ministry of Training, Colleges and Universities (MTCU)

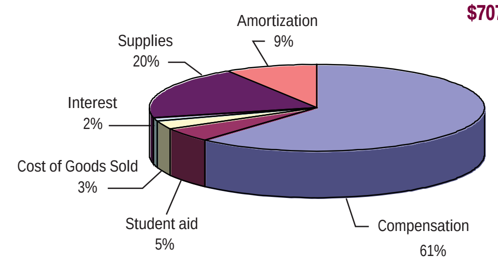
2006/07 Total Revenue
$731.0 million



Strategic Deployment of Resources

- expenses increased by $30.5 million (4.5%), as a result of growth in enrolment (3.4%), and compensation costs
- compensation expense increased by 8.4% due to the costs of employee future benefits of $64.2 million (2005/06-$57.0 million)
- the proportion of expenses spent on student financial aid remains constant

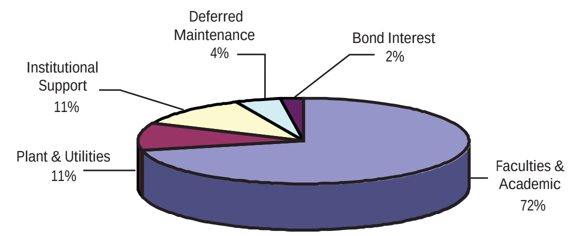
2006/07 Total Expenses
$707.3 million



Strategic Deployment of Resources

- 72% of operating expense is invested into academic, academic support and student support budget envelopes (2005/06-74%)
- the proportion of operating expenditures made in physical plant and utilities and institutional support remained constant from 2005/06. The proportion of deferred maintenance increased by 3% to 4%

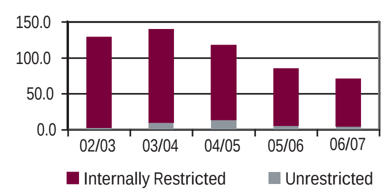
2006/07 Operating Fund Net Expenditures by Envelope
$323.7 million



Strengthen Financial Position

- $14.2 million decrease of total operating net assets
- internally restricted net assets decreased by $13.5 million:
  - decrease in employee future benefit reserves of $24.3 million
  - increase in specific purpose reserves related to an $8.6 million increase in unexpended departmental carry forwards

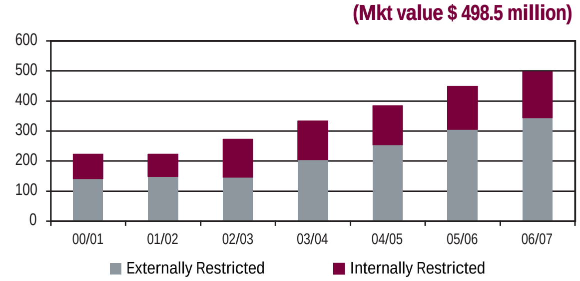
Operating Net Assets
$ millions



Strengthen Financial Position – growth in endowment funds

- market value of all endowments at $498.5 million increased 11.0%
- endowment per FTE student of $21,800 increased 7.3%
- external endowments (including deferred donations) increased 12.6%
- net investment return of 11.0% (2005/06-14.2%)

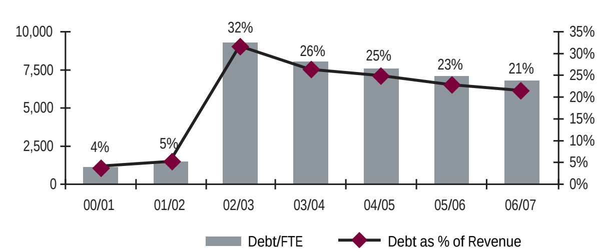
Growth in Endowment Funds
(Mkt value $ 498.5 million)



Manage Business Risks – long term debt

- long term debt of $156 million decreased marginally
- long term debt per student at $6,823 decreased (2005/06- $7,091)
- a total of $32 million ($1,397 per FTE) of capital project debt was financed internally
- sinking funds amounted to $15.0 million of which $10.5 million is available to repay the $120 million debenture principal in 2052

Long Term Debt Ratios



Achieve Strong Demand for Programs

In 2006/07, the University achieved its goal of increasing demand for its programs and meeting student enrolment targets. McMaster's culture of innovation in linking teaching and scholarship and its reputation for problem based learning and inquiry-based programs continues to be a strong attraction for academically high achieving students.

The number of applications to McMaster programs increased by 5.7% over 2005/06 which was in line with the rate of increase in applications to all Ontario universities. The proportion of applicants who named McMaster as their first choice is one indicator of the demand for a McMaster education. In 2006/07, this proportion increased by 12.4% over 2005/06. The percentage of McMaster offers that were accepted by students at 22% remained constant with 2005/06.

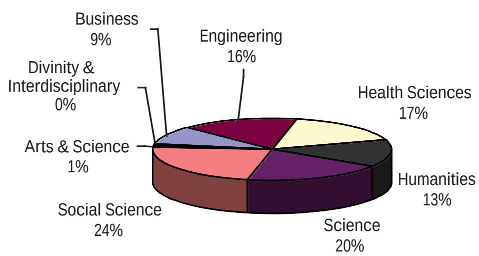
Full time equivalent (FTE) enrolment in 2006/07 increased by 3.4% over the previous year and 0.6% over the target for the year, reflecting the alignment of Provincial government initiatives with McMaster's 2006/07 commitment to provide access to post-secondary education to a growing number of qualified students. The increase in FTE enrolment was made up of a 2.9% increase in undergraduate enrolment and an 8.0% increase in graduate enrolment. Increased graduate student enrolment is a key component of the *Refining Directions* strategic plan and is consistent with the Ontario government's *Reaching Higher, A plan for Post-secondary Education strategy*.

The University has achieved its FTE enrolment target without wavering on its commitment to enhancing the entering average of the Level 1 class. In 2006/07, McMaster achieved the following improvements in student quality:

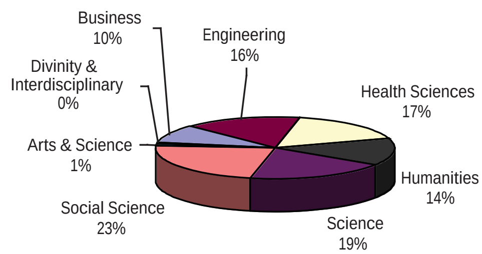
- The overall entry grade for students coming directly from Ontario secondary schools increased to 83.5% (2005/06-82.9%).
- McMaster's percentage of Level 1 students with an entering average of greater than 80% increased from 69.7% in 2005/06 to 73.7% in 2006/07.
- The percentage of Level 1 students entering with an average grade over 90% increased from 12.7% in 2005/06 to 15.5% in 2006/07.

Student enrolment in 2006/07 continues to be well distributed through the University's six Faculties. In 2006/07 the faculties of Science and Social Science each increased their share of students by 1%.

2006/07 FTE Enrolment
22,903 FTEs



2005/06 FTE Enrolment
22,140 FTEs



- Looking forward to 2007/08, enrolment has increased over 2006/07 and over targeted levels which creates strain on both human and capital resources. The Provincial commitment to adequately fund the 2007/08 increases in enrolment is unclear. Accepting inadequately funded students threatens the very core of McMaster's strategic advantage by increasing student faculty ratios and class sizes and reducing our ability to provide an experiential learning environment. The University will closely monitor the quality and financial impact of the increase in enrolment on the three year financial plan to 2010.

On a provincial level, it has become clear that there is still a large unmet need to expand undergraduate enrolment in the greater Toronto area (GTA) where an increase of 45,000 to 70,000 undergraduate students is anticipated by 2015. The Province is investigating options including further university expansion. The McMaster community will engage in a discussion of future growth and how it interacts with the strategic plan in formulating its future enrolment targets.

Increase and Diversify Revenues

In 2006/07, the University achieved its goal of increasing revenues by 6.7% over 2005/06 to $731.0 million. This translated to revenue per FTE enrolment of $31,900, which is 3.0% higher than 2005/06. This increase in per student funding is not sufficient to provide for a quality education experience and cover inflationary costs without implementation of budget reduction strategies.

The diversity of the University's revenue sources eroded slightly in 2006/07 and its reliance on government grants increased to 30% of total revenue compared to 26% in 2005/06. The increase in government grants is due to a 20% increase in year-over-year operating grant revenue, much of which was one-time in nature and received at the end of the year.

Total revenue over a five year time period from 2002/03 to 2006/07 has increased by over 60%. During that time period, diversification of the funding base was achieved through continued increases in research funding and other sources generated by faculties, non-academic areas, fund-raising, investment income and ancillary operations.

Operating Grants Income

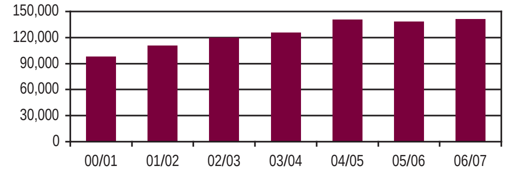
Provincial government operating grants of $202.2 million increased by $34.3 million over 2005/06, of which $21.9 million was announced and received in March 2007. Increases in provincial operating grants relate to enrolment growth, enhanced funding for clinical and medical education, and 'Reaching Higher' provincial investments for quality, as well as the unanticipated one time year end grants which were partly used to fund health and safety academic building upgrades.

In 2007, the Federal government announced $800 million in new funding for post-secondary education through increased transfer payments to the provinces. The new funding will commence in 2008/09 and rise at a 3% inflation factor each year. There is no certainty that these funds will be used by the Province as intended; however, the University requires these funds to mitigate the impact of increases in costs that consistently outpace increases in provincial revenues.

Research Grants and Contracts

Research revenue recognized over the past year has increased 1.8% to $141.1 in 2006/07 (2005/06-$138.6 million). Total research funding received grew by $3.3 million. A significant portion of this funding will support capital expenditures. Research growth over the past years has been dramatic and illustrates McMaster's success in creating internationally recognized centres of research excellence, building the infrastructure to support strategic research areas and integrating scholarship with teaching. This revenue has been an important driver in the University's total revenue growth and diversification.

Research Revenue Recognized
$ 000's



Research revenue is recognized as income in the year in which the expense occurs. Unspent research revenue and revenue spent on capital projects is deferred and recorded as Deferred Contributions on the Statement of Financial Position. In 2006/07, $30.6 million (2005/06-$29.8 million) was deferred for future use.

		$ millions
RESEARCH REVENUE RECOGNIZED	**2006/07**	**2005/06**
Federal Government	101.7	76.0
Province of Ontario	13.9	15.1
Other sources	56.1	77.3
Total research funds received	171.7	168.4
Less amount deferred to future	(30.6)	(29.8)
	141.1	**138.6**

Despite the competition among Canadian universities for research funding, future prospects for increased growth are strong. The Ontario Research Fund has recently invested significant funds into McMaster projects and the University is well positioned to capitalize on the opportunities in the Federal government's recently announced new science and technology strategy. In the 2006 rankings of Canada's top 50 research universities by Research Infosource Inc., McMaster ranked first in the country in research intensity and third in its ability to capitalize on its research income.

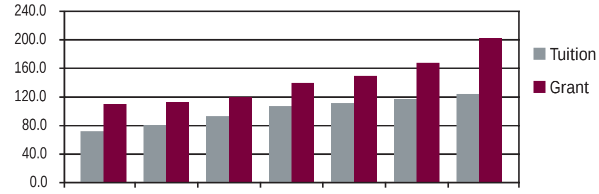
Research Overhead Grants

Research overhead grants assist the University in funding the indirect costs of research. In 2006/07, $14.2 million was received (2005/06-$13.4 million). The Province and the Federal Government funds a portion of overhead costs associated with the federal research granting councils and eligible provincial research programs. The average indirect cost reimbursement rate in 2006/07 of 26.2% is far short of the minimum required rate of 40%.

Tuition Fees

Revenue from tuition fees has increased by 5.8% in 2006/07 as a result of a 3.4% growth in students and an increase in tuition fees as allowed by the Province. In March 2006, the Province announced a tuition fee setting policy, covering 2006/07 to 2009/10, which permits the University to increase tuition fees for regulated programs by an overall maximum of 5% per year. In 2006/07, the University increased fees by the maximum allowable increase for each regulated program. A slight change in mix of students towards proportionately more arts and science and graduate students and less than targeted visa students partially offset the positive impact of price and volume. The ratio of tuition-to-grant revenue has declined mainly as a result of the significant year-end one time provincial funding increases.

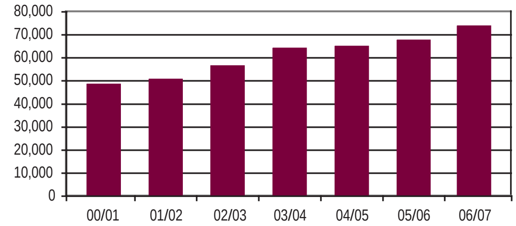
Operating Grant vs Tuition Income $ millions



Ancillary Operations

Ancillary operations have a mandate to provide excellent services and operate at break-even by covering all operating and capital costs through revenue earned. In addition, the Bookstore and Hospitality Services continue to provide a substantial contribution in support of essential soft Student Services. Total internal and external sales by ancillary operations grew significantly by 9.3% to $74.1 million in 2006/07.

Ancillary Sales Growth
$000's



A detailed breakdown of Ancillary revenues and year over year growth rates follows:

	$ thousands		
SALES BY ANCILLARY OPERATIONS	**2006/07**	**2005/06**	**% increase**
Bookstore	21,508	20,575	4.5%
Hospitality Services	18,428	16,737	10.1%
Housing and Conference Services	18,442	15,475	19.2%
Printing	5,131	5,132	0.0%
Parking	3,768	3,333	13.1%
Continuing Education	2,471	2,308	7.1%
Telecommunications	2,731	2,664	2.5%
Student Health Services	1,447	1,417	2.1%
Miscellaneous	162	142	14.1%
	74,089	67,783	9.3%
Less internal sales	(9,951)	(9,689)	2.7%
	64,138	**58,094**	**10.4%**

Hospitality Services and Housing and Conference Services revenue benefited from the 3.4% increase in enrolment, and the opening of the new residence and a strong business strategy.

Investment Income

Investment income, allocated to operations amounted to $40.1 million (2005/06-$44.7 million). In addition, $18.8 million (2005/06-$21.9 million) of investment income was allocated to External Endowments under the endowment capital protection policy. These returns reflect strong investment markets with an annual net rate of return of 11.0%.

Investment returns on total endowed funds are used in accordance with the purposes set out by donors or the Board of Governors. The amount of annual income budgeted for expenditure on designated uses was set at a maximum of 4% of the three-year average market value of endowment capital. In 2006/07, approximately 3.9% (2005/06-3.6%) of expenses were funded through endowment income, a significant proportion of which was directed towards student scholarships and bursaries and faculty compensation.

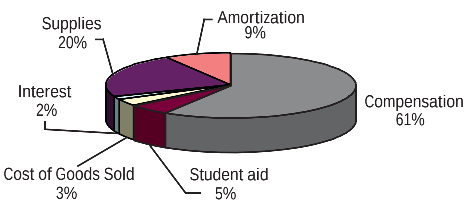
OTHER SOURCES OF REVENUE

Other sources of revenue include:

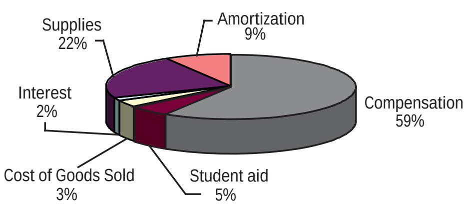
- $71.1 million earned through various non-degree educational and other revenue-generating activities (2005/06-$61.9 million)
- $36.2 million of donations and other grants received for restricted activities (2005/06-$43.1 million). The 2005/06 amount included $15 million of grants that were recognized when flowed to McMaster Innovation Park (MIP)
- $38.3 million in amortization of capital assets from deferred capital contributions (2005/06-$40.8 million)

Strategic Deployment of Resources

2006/07 Total Expenses
$707.3 million

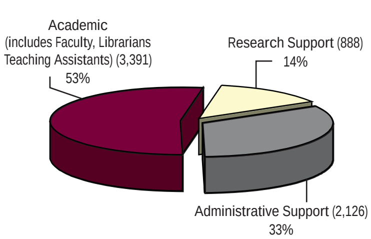


2005/06 Total Expenses
$676.8 million



Total expenses for 2006/07 increased by 4.5%

Faculty Members and Staff
October 2006
Total Staff: 6,405



Over the past several years, there has been little substantive change in how operating funds have been allocated. In 2006/07, 72% of operating expenditures have been made by direct academic, academic support and student support budget envelopes. This compares to 74% in 2005/06. The percentage of operating expenditures made in physical plant, utilities and deferred maintenance increased by 3% to 15% and the proportion spent in support of the institution remained constant at 11%.

Compensation

A total of 6,405 staff members were employed in October 2006 (October 2005-6,266) with approximately 67% of these employees being involved in direct academic and research activities and 33% in administrative support (see chart at lower left).

Total compensation expense of $436.5 million represents 61.7% of total expenses. The increase of 8.4% over 2005/06 is the result of faculty and staff growth of 2.2%, salary adjustments and accelerating costs of providing employee pension and other retirement benefits.

Employee benefits increased by 10.5% from 2005/06 but remained unchanged as a percentage of salaries and wages at 30%. The expenses related to pension and other future employee benefits dominate the increase in total benefit costs. While positive steps have been taken to manage the rate of growth of pension and non pension future benefits through changes in plan design, these costs continue to put pressure on operating and research budgets.

It is apparent that with compensation costs escalating at a rate greater than revenue, cost saving measures will need to be continued to establish long term sustainability. The Three Year Financial Plan approved in June 2007 identifies saving strategies which include the reduction of 41 faculty and staff positions over three years. The majority of these reductions will take place in administrative and support areas.

There are many direct and indirect consequences of the budget reduction, which vary in their impacts on each unit and the university as a whole and include:

- acceptance of increased levels of risk in offices where retiring staff has not been replaced
- increased class sizes and increasing student-to-faculty ratios
- cancellation of sections, which leads to larger classes and difficulty scheduling large rooms
- increased number of part-time instructors
- cancellation of some electronic journal subscriptions
- decrease in library acquisitions, including books and monographs
- increased workloads for faculty and staff
- decreased support for student services

Strategies, such as initiation of the Teaching-Stream faculty position and the faculty retirement incentive program, were implemented in 2006/07 to assist with mitigating the impact of budget reductions.

In December 2006, Senate and the Board of Governors approved the Teaching-Stream faculty position. The Teaching-Stream positions have been designed to deal with two closely related issues: the existence of long-term Contractually Limited positions and the desire to develop a small number of new positions for people who will specialize in teaching. Educational specialists of this type can cost-effectively enhance McMaster's significant international reputation in teaching and learning. Appointments in this category will begin in 2007/08.

A faculty retirement incentive program was approved by the Board of Governors in March 2007. The purpose of the plan is twofold: to achieve the required base budget reductions, and facilitate faculty renewal.

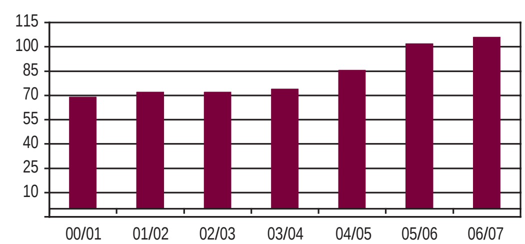
Retirement incentives will only be granted where base budget savings are generated and where the departure does not weaken the ability of the University to achieve the mission. As each Faculty completes its retirement incentive plan, it will balance the hiring of new faculty in key strategic areas with savings. The approved ceiling cost of the program of $7 million will be funded from a reduction of the internal endowment.

Student Financial Aid

Student aid (scholarships and bursaries) of $37.9 million increased by 3.8% (2005/06-$36.5 million).

To provide support for funding the growing need for financial assistance, McMaster has increased its endowments held for scholarships and bursaries from $102 million in 2005/06 to $112 million in 2006/07. In May 2005, the Ontario Trust for Student Support was introduced. This matching program has provided further donations and government matching funds for student financial aid.

Funds held for Scholarships and Bursaries $ millions



The Province's new tuition fee setting policy includes the implementation of the Student Access Guarantee ("SAG"). The SAG is intended to ensure that no qualified Ontario student be prevented from attending Ontario's public colleges and universities due to lack of financial support programs or lack of access to the resources they need for their tuition and books and mandatory fees. The results of implementing SAG will be assessed in future years.

Capital Planning and Management

The McMaster Campus Plan provides a comprehensive framework to guide campus capital development. The plan is reviewed annually to ensure that the physical infrastructure is an appropriate reflection of McMaster's academic excellence. Under the plan, the University has embarked on extensive capital improvements designed to provide "state of the art" academic and research facilities to support a leading-edge University. A significant number of the major buildings have been renovated or expanded by projects which have been funded through a variety of government programs, such as SuperBuild and Canada Foundation for Innovation, as well as private donations and the $120 million debentures issued in 2002. In 2007, the bulk of these projects have been completed.

Since 2002, the University has enjoyed significant success and achieved growth in enrolment, research and innovative programs. In order to meet its current objectives and to achieve future goals, an ambitious plan has been set to expand and improve physical capacity.

The following chart outlines the major projects which are currently under construction.

PROJECT	BUDGET	FUNDING SOURCES	EXPECTED COMPLETION
Ronald V. Joyce Stadium (includes underground parking)	$34.5 million	Parking fees, pledges and fundraising	2008
Arthur Bourns, Burke Science General Science Renovations	$11.5 million	University sources	2008
New Engineering Building	$38 million	MTCU Graduate grants, fundraising, University	2009

Projects with long term funding sources such as student levies, user fees, parking levies, and future fundraising are currently being financed through internal loans. Internal loans have grown from $22.9 million in 2005/06 to $32.8 million in 2006/07 and have various recovery terms and periods. Upon completion of a debt management strategy in 2008, recommendations will be brought to the Board of Governors to:

- prioritize identified capital expansion plans
- consider the internal loan strategy
- develop a plan for external borrowings

Investment in Capital Assets

McMaster expended $105 million for capital acquisitions in 2006/07. These expenditures are outlined in the following chart.

CAPITAL ASSET ADDITIONS	2006/07 $ thousands
Land	$ 17
Completed building projects and construction in progress	61,901
Computers, furnishings and other equipment	38,686
Library materials	4,796
	$ 105,400
FUNDING SOURCE FOR ADDITIONS	
Deferred capital contributions	$ 53,473
Debenture proceeds	3,082
Internally funded (includes internal loans)	48,845
	$ 105,400

Strategic Deployment of Resources – Looking Forward

The President has announced the undertaking of a program prioritization review across academic and non-academic programs. The goal is to ensure that resources are strategically allocated to support the University's mission while ensuring long-term financial sustainability. This review is to be initiated in 2007/08 under the direction of the Provost and Vice-President (Academic) and the Vice-President (Administration). To support the program prioritization process and to ensure that the budget enables the University to meet its short and long-term goals, the Provost and Vice-President (Academic) and the Vice-President (Administration) will convene a committee to review and recommend changes to the McMaster Operating Budget Model.

The University has also embarked on a review of its capital project prioritization and debt management processes. The purpose of the review is to develop a debt management plan that sets the strategic context for capital project prioritization and establishes principles regarding the use of debt. It is expected that the debt management plan will be approved in 2007/08 and will support the recommendations for changes to the Operating Budget Model, resulting in an enhanced consolidated budgeting process.

Strong Financial Position and Management of Business Risks

Successful fundraising and strong investment returns improved the position of endowments.

On balance, the financial position was strengthened in 2006/07:

STRENGTHS

- Total assets amounted to $1.7 billion compared to $1.6 billion in 2005/06, a growth of 6.2%.
- Net assets of $693.3 million increased by $64.6 million from 2005/06 primarily due to an increase of $27.0 million in the amount of net assets invested in capital assets and an increase of $40.9 million in external endowments.
- Total endowment per FTE student increased to $21,800 (2005/06-$20,300).
- Departmental carry-forwards of $49.5 million increased by $8.6 million signaling positive in year results for many departments.
- Long-term debt per FTE student decreased to $6,823. The sinking fund established in 2002 to repay the $120 million of debentures in 2052 has increased to $10.5 million (2005/06-$9.5 million).

CHALLENGES

- Liabilities and deferred contributions of $960.9 million increased by 3.4% over 2006/07, primarily due to an increase in accrued employee future benefits of $16.8 million.
- Operating net assets, which include unrestricted, employee future benefits and specific purpose reserves declined by $14.2 million. The decline of $24.3 million in the employee future benefits reserve due to the required pension and employee future benefit liability increases was offset by an increase in other specific reserves.
- Internal loans to capital projects increased to $32.8 million (2005/06-$22.9 million).

Internal and External Endowments

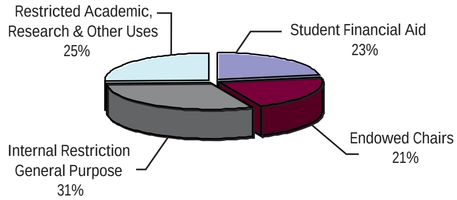
Endowments are comprised of restricted donations and donations that have been internally restricted by the Board of Governors. The Internal Endowments had a market value of $154.8 million (2005/06 – $143.9 million) and External Endowments, including deferred contributions, had a market value of $343.7 million (2005/06 - $305.4 million).

The market value of the University's total endowment of $498.5 million as at April 30, 2007, has grown by $49.2 million (11.6%) compared to 2005/06. Endowment donations of $31.7 million and investment income of $45 million exceeded $27.4 million of expenditures from endowment funds.

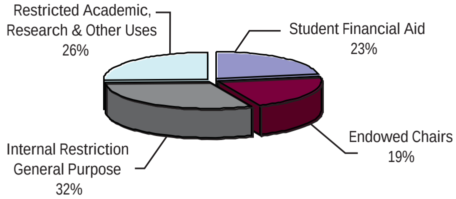
The endowment fund investment policy requires diversification between fixed income (40%) and equity securities (60%) and generated an annual rate of return, measured at March 31, 2007, of 10.7% (2005/06 –13.95 %), which is 0.20% higher than the policy benchmark. Under the direction of the Finance Committee, the University regularly reviews its asset mix and monitors the performance of its investment managers.

Investment returns on endowed funds support strategic areas of expenditures. Funds for student scholarship and bursaries represent 23% of total endowments and funds held to support faculty salaries and research activities through the endowed chairs program represent 21%. Restricted academic research and other uses represent 25% of the total endowments held.

Endowment Funds at April 30, 2007
By Purpose
$498.5 million



Endowment Funds at April 30, 2006
By Purpose
$449.3 million



The University has plans to utilize $27.6 million of internal endowments over the next three years. $7.0 million will be used in 2007/08 and 2008/09 to pay for the faculty retirement incentive program. $20.6 million will be used to fund salaried pension plan deficit payments that are expected to be recovered from operating funds over a long-term period. The terms of the recovery plan have not been finalized.

Employee Future Benefits (Pension and Other)

The University records the benefits plans' asset and liability values and the related expenses as determined actuarially. Any actuarial gains or losses, including changes resulting from adjustment of actuarial assumptions and investment experience gains and losses, are amortized to income using the corridor method over the average remaining service life of active employees.

Pension

The funded status of the defined benefit pension plans, measured at April 30, 2007, is a deficit of $98.8 million (2005/06-deficit of $92.4 million). The change is attributable to the actuarial loss resulting from a reduction in the discount rate assumption, partially offset by better-than-expected investment returns.

The change in the funded status of the defined benefit pension plans from April 30, 2006 to April 30, 2007 is summarized as follows:

CHANGE IN FUNDED STATUS OF PENSION BENEFIT PLANS

	$ millions
Funded status, April 30, 2006	**(92.4)**
Costs in the period:	
Current service cost	(32.5)
Interest on liabilities	(60.7)
Actual return on plan assets	117.4
	24.2
Actuarial loss related to changes in discount rate and salary assumptions	(42.4)
Actuarial loss related to changes in assumptions	(30.0)
Past service cost reductions	1.1
University contributions	40.7
Funded status, April 30, 2007	**(98.8)**

Investment returns were stronger than expected and exceeded current service cost and interest on liabilities generating a net reduction in the deficit position. This reduction was more than offset by changes in actuarial assumptions ($42.4 million) and the impact of updating of the accounting valuation to reflect the July 2006 actuarial valuation for funding purposes ($30.0 million). A change in the discount rate to 5.3% from 5.5% was required to reflect the market interest rate on April 30, 2007. This small discount rate reduction had a sizable impact on the funded position due to the long (17 year) duration of the liabilities. There was no change for the expected long-term rate of return on plan assets at 7.0%.

The pension expense for 2006/07 of $41.9 million (2005/06-$36.6 million) includes amortization of actuarial losses of $14.0 million (2005/06-$13.9 million).

The University submitted its tri-annual funding valuation for the salaried pension plan as of July 1, 2006 and is required to submit the funding valuation for the hourly pension plan as of July 1, 2007. A funding plan that identifies the salaried pension plan contributions to be made prior to the next valuation has been completed. In 2006/07, deficit amortization payments of $5.2 million were funded from an internal reserve. Subsequent payments estimated at $20.6 million will be funded from internal endowments and are expected to be recovered from operating funds over a long-term period.

The University has adopted measures to reduce future pension expenses including the following:

- employees who began at McMaster July 1, 2006 or later will not be subject to two-year vesting
- the employee contribution rate for the majority of active members has increased by .75% of pensionable salary each in 2006/07 and in 2007/08
- for Canadian Auto Workers (CAW) employees, the contribution rate increases by an additional .5% of salary in 2008/09
- for selected employee groups factor 80 retirements for early unreduced pension will increase, on a gradual basis, to factor 85 by 2011

Other - Post Retirement and Post Employment Benefit Plans

The deficit status of the non-pension post retirement benefit plan as at April 30, 2007 amounted to $223.3 million, an increase of $39.1 million from April 30, 2006. The significant changes are outlined in the chart below:

CHANGE IN FUNDED STATUS OF NON-PENSION BENEFIT PLANS

	$ millions
Funded status, April 30, 2006	**(184.2)**
Costs in the period:	
Current service cost	(7.7)
Interest on liabilities	(10.6)
	(18.3)
Actuarial loss related to change in assumptions for discount rate	(22.1)
Other	(2.9)
University contributions	4.2
Funded status, April 30, 2007	**(223.3)**

A full actuarial valuation was completed in May 2007. Based on advice from the actuary, the assumptions used to project the cost of future health benefits were adjusted and a more conservative mortality table was incorporated into the calculation of the obligation. The discount rate is based on high quality corporate bond yields as at April 30, 2007, resulting in a reduction in the rate of 0.5%, which accounts for 57% of the increase in the liability.

Non-pension future employee benefit expense in 2006/07 of $22.2 million increased by $1.7 million from 2005/06. The increase reflects higher current service and interest costs as well as the requirement to amortize $3.9 million of actuarial losses.

The University continues to fund future non-pension benefits on a cash basis and has budgeted $4.9 million in 2007/08. This amount is consistent with estimates provided by the actuaries. Expected cost increases for future years as projected by the actuaries are being incorporated into multi-year financial plans to ensure that funds are available to cover this increasing cost.

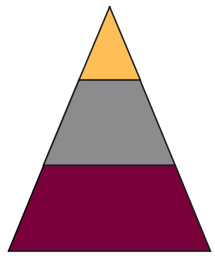
In 2005/06 and 2006/07, the University made changes to the design of current post retirement benefit plans to ensure value-for-money, cost effectiveness and cohesion with its human resource strategic goals and objectives.

Risk and Control Environment Management

An essential component of the University's Refining Directions initiatives is the identification and mitigation of *risk* at all levels within its activities. Within strategic and operational contexts, the process can be summarized as follows:

" … a structured and disciplined approach that aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces."

Risk and its mitigation can be categorized into three distinct and interrelated components as highlighted in the following chart:



- **Enterprise-wide:** strategic measures taken to protect assets, reputation and competitive position
- **Business processes:** internal controls and procedures designed to mitigate risk as a result of interacting with internal and external factors in conducting University business and activity
- **Tangible assets:** basic protection of assets through insurance and other programs

The University has installed comprehensive processes to monitor risk and the effectiveness of controls thereof in each of the distinct levels.

The *Enterprise Wide Risk Management* program ("EWRM") is monitored on behalf of the Audit Committee by the Internal Audit Department and with the respective Risk Owners. For monitoring purposes, strategic risks have been grouped into two distinct groups:

GROUP 1	GROUP 2
Technology	Government policy
Physical infrastructure	Partnering
Student satisfaction	Change readiness
Financial	Leadership
Human capital and employee relations	Reputation
	Competitor

The *Internal Audit Plan* considers the linkages among enterprise, business processes, protection of assets and business activities in the effort to direct the monitoring and audit efforts according to the significance of the risk ranking in each area according to the risk events' potential impact and their likelihood of occurrence.

To manage and monitor the effectiveness of controls at all risk levels, the University has instituted a variety of initiatives including the following:

- Internal Audit Department reviews which provides assurance and consulting services through a comprehensive risk based audit and process review plan
- on going communication with its External Auditors
- comprehensive set of risk management and health and safety policies that are monitored and reported on to the Board of Governors by the Environmental and Occupational Health Support Services department
- monitoring of legal and other claims
- the establishment of a Fraudulent Activity and Whistle Blower policy including the installation of a dedicated web site for reporting such activity in confidence

The University has initiated a process to prioritize its academic and non academic programs and capital projects and to revitalize its budgeting and debt management strategies with a focus on the future and the vision: *to be among the best in the world.*

Conclusion

The University achieved a positive financial outcome in the 2006/07 year:

- it continues to achieve strong demand for its programs and to meet its enrolment targets
- revenue increased by 6.7% mainly due to the additional funding received from the provincial government in the last month of its fiscal year
- unexpected provincial grants had a positive impact on departmental carry forwards and increased the amount of reserves available for future periods
- research funding continues to reflect the very strong achievements by McMaster researchers in an increasingly competitive environment
- successful fundraising and strong investment returns improved the position of endowments

The University has developed plans and strategies to build on its successes and better manage its financial challenges. The University will continue to experience rising costs due to salary and wage settlements, increased benefit costs, increasing operating costs and other inflationary increases. It is expected that revenues will fail to keep pace with these rising costs and the identified budget reduction strategies will need to be made.

The University has initiated a process to prioritize its academic and non academic programs and capital projects and to revitalize its budgeting and debt management strategies with a focus on the future and the vision: *to be among the best in the world.*

Supplemental Information: Operating Fund and Operating Budget

The audited financial statements are prepared as required by statute in accordance with generally accepted accounting principles ("GAAP") as prescribed by the Canadian Institute of Chartered Accountants under the *Deferral Method* of accounting ("deferral method") and with consolidation of all activity. For external reporting under the deferral method, all funds are consolidated in a single column on the Statement of Operations.

In contrast, the University's internal reports and budgets are prepared on a *cash basis* and pursuant to the concepts of *fund accounting*. Under this method, separate budgets and funds are set up for funds' activities, with each fund comprised of its own assets, liabilities, revenues and expenses.

Fund accounting enhances accountability and budgetary control of resources by ensuring that restricted grants and contributions are spent only for the purposes intended. To maintain control, the following segregated funds have been developed: Operating, Research, Capital, Externally Restricted Trusts and Endowments, Internally Restricted Endowments and Ancillary Operations.

The Operating Fund includes all revenue and expenses related to annual activities for academic program delivery and accounts for over half of all spending. The 2006/07 Operating Budget was particularly challenging to balance and a deficit of $14.9 million was initially expected when the Budget was received by the Board in June 2006. The information below provides a summarized comparison of actual results to budget for the Operating Fund on a cash basis.

2006/07 OPERATING FUND - $ millions	Budget	Actual	Variance
Sources of revenue	$ 382.2	$ 400.1	$ 17.9
Expenditures	397.0	392.0	5.0
Amount funded by unrestricted net assets	–	0.5	0.5
Excess (deficiency) of revenue over expenditures	**(14.8)**	**8.6**	**23.4**
Fund balance, beginning of year	40.9*	40.9	–
Fund balance, end of year	**$ 26.1**	**$ 49.5**	**$ 23.4**

*adjusted to actual

Total operating fund revenues were $400.1 million as compared to the budgeted funding of $382.2 million. The positive variance of $17.9 million was due primarily to:

- unexpected year-end funding of $15.7 million from the Ministry of Training, Colleges and Universities
- an additional $2.7 million of investment revenue

Total Operating Fund expenditures were $392.0 million as compared to the budgeted expenditures of $397.0 million. The positive variance of $5.0 million (1.3%) was due primarily to a reduction in non salary spending offset by higher than budgeted salary and wage expense.

As a result, budget appropriations transferred to internally restricted net assets increased by $8.6 million, which was $23.4 million higher than anticipated. These appropriations will provide funds to offset future deficits expected in some envelopes in 2007/08 as the strategies to reduce structural deficits are implemented.

Financial Statements – April 30, 2007

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McMaster University

Statement of Management Responsibility

The management of the University is responsible for the preparation of the financial statements, the notes thereto and all other financial information contained in this Annual Financial Report.

The management has prepared the financial statements in accordance with Canadian generally accepted accounting principles developed by The Canadian Institute of Chartered Accountants. The management believes the financial statements present fairly the University's financial position as at April 30, 2007 and the results of its operations, changes in net assets and its cash flows for the year then ended. In order to achieve the objective of fair presentation in all material respects, the use of reasonable estimates and judgements were employed. Additionally, management has ensured that financial information presented elsewhere in this Annual Financial Report has been prepared in a manner consistent with that in the financial statements.

In fulfilling its responsibilities and recognizing the limits inherent in all systems, the management has developed and maintains a system of internal controls designed to provide reasonable assurance that University assets are safeguarded from loss and that the accounting records are a reliable basis for the preparation of financial statements.

Mercer Human Resource Consulting Ltd. has been retained by the University in order to provide an estimate of the University's current year position for pension and other employee future benefits. Management has provided the valuation actuary with the information necessary for the completion of the University's report and retains ultimate responsibility for the determination and estimation of the pension and other employee future benefits liabilities reported.

The Board of Governors carries out its responsibility for review of the financial statements and this Annual Financial Report principally through the Finance Committee and its Audit Committee. The majority of the members of the Audit Committee are not officers or employees of the University. The Audit Committee meets regularly with the management, as well as the internal auditors and the external auditors, to discuss the results of the audit examinations and financial reporting matters, and to satisfy itself that each party is properly discharging its responsibilities. The auditors have full access to the Audit Committee with and without the presence of the management.

The financial statements for the year ended April 30, 2007 have been reported on by KPMG LLP, Chartered Accountants, the auditors appointed by the Board of Governors. The Auditors' Report outlines the scope of their audit and their opinion on the presentation of the information included in the financial statements.

Dr. P. George	Ms. K. Belaire
President and Vice-Chancellor	Vice-President, Administration
August 3, 2007	August 3, 2007

Auditors' Report

To the Board of Governors of McMaster University

We have audited the statement of financial position of McMaster University as at April 30, 2007 and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the University as at April 30, 2007 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
August 3, 2007, except for note 11 which is as of October 12, 2007

McMASTER UNIVERSITY
Statement of Financial Position
April 30, 2007, with comparative figures for 2006
(thousands of dollars)

	2007	2006 (note 17)
Assets		
Current assets:		
Cash and equivalents	$ 88,107	$ 89,231
Government grants and other accounts receivable	44,699	42,404
Research grants receivable	73,416	71,196
Inventories	4,729	6,039
Prepaid expenses	4,752	907
	215,703	209,777
Investments (note 2)	588,398	538,112
Investment in McMaster Innovation Park (note 3)	13,318	13,460
Capital assets (note 4)	613,812	570,842
Deferred pension asset (note 5)	222,972	225,409
	$ 1,654,203	$ 1,557,600
Liabilities, Deferred Contributions and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 75,089	$ 84,010
Deferred revenue	30,267	28,267
Current portion of long-term obligations	937	881
	106,293	113,158
Accrued employee future benefits (note 5)	182,651	165,813
Long-term obligations (note 6)	160,755	161,428
Deferred contributions (note 7):		
Deferred for future expenses	211,374	203,877
Deferred capital contributions	299,796	284,591
	511,170	488,468
Net assets:		
Operating:		
Unrestricted	4,929	5,651
Internally restricted (note 8)	66,110	79,624
Equity in capital assets (note 9)	177,052	150,099
Endowments (note 10):		
Internal	154,823	143,878
External	290,420	249,481
	693,334	628,733
Commitments and contingencies (note 11)		
	$ 1,654,203	$ 1,557,600

On behalf of the Board of Governors:

Chair, Board of Governors

President and Vice-Chancellor

 See accompanying notes to financial statements

McMASTER UNIVERSITY
Statement of Operations
Year ended April 30, 2007, with comparative figures for 2006
(thousands of dollars)

	2007	2006
Revenue:		
Operating grants	$ 202,151	$ 167,864
Research grants and contracts	141,142	138,593
Tuition fees	123,761	116,963
Ancillary sales and services	64,138	58,094
Other	71,087	61,900
Investment income, net	40,052	44,703
Donations and other grants	36,212	43,136
Research overhead grants	14,155	13,366
Amortization of deferred capital contributions	38,268	40,753
	730,966	685,372
Expenses:		
Salaries and wages	334,776	310,585
Employee benefits	101,671	92,037
Supplies and services	197,140	203,967
Interest on long-term debt	11,145	11,383
Share in loss of McMaster Innovation Park	142	32
Amortization of capital assets	62,430	58,806
	707,304	676,810
Excess of revenue over expenses	$ 23,662	$ 8,562

McMASTER UNIVERSITY
Statement of Changes in Net Assets
Year ended April 30, 2007, with comparative figures for 2006
(thousands of dollars)

	Operating							
		Internally restricted						
		Employee future	Specific	Equity in	Endowments		2007	2006
	Unrestricted	benefits	purposes	capital	Internal	External	Total	Total
								(note 17)
Net assets, beginning of year	$ 5,651	33,738	45,886	150,099	143,878	249,481	628,733	575,830
Excess (deficiency) of revenue over expenses	47,824	-	-	(24,162)	-	-	23,662	8,562
External endowment contributions:								
Contributions	-	-	-	-	-	22,186	22,186	22,488
Protection of capital	-	-	-	-	-	18,753	18,753	21,853
Transfers and adjustments:								
Transfers for specific purposes	13,514	(24,343)	10,829	-	-	-	-	-
Capital transactions from operating (note 9)	(51,115)	-	-	51,115	-	-	-	-
Transfer to internal endowments	(10,945)	-	-	-	10,945	-	-	-
	(722)	(24,343)	10,829	26,953	10,945	40,939	64,601	52,903
Net assets, end of year	$ 4,929	9,395	56,715	177,052	154,823	290,420	693,334	628,733

See accompanying notes to financial statements

McMASTER UNIVERSITY
Statement of Cash Flows
Year ended April 30, 2007, with comparative figures for 2006
(thousands of dollars)

	2007	2006
		(note 17)
Cash flows from operating activities:		
Excess of revenue over expenses	$ 23,662	$ 8,562
Adjustments for non-cash items:		
Amortization of deferred capital contributions	(38,268)	(40,753)
Amortization of capital assets	62,430	58,806
Increase in accrued employee future benefits	16,838	16,571
Increase in decommissioning obligation	264	250
Change in deferred pension asset	2,437	13,106
Share in loss of McMaster Innovation Park	142	32
	67,505	56,574
Net change in contributions deferred for future expenses	7,497	(5,866)
Change in net non-cash working capital	(13,971)	28,036
	61,031	78,744
Cash flows from financing and investing activities:		
Purchase of capital assets	(105,400)	(127,547)
Net increase in investments	(50,286)	(60,969)
External endowment contributions	40,939	44,341
Deferred capital contributions	53,473	41,185
Principal repayments on long-term obligations	(881)	(828)
Increase in Investment in McMaster Innovation Park	-	(100)
	(62,155)	(103,918)
Net decrease in cash	(1,124)	(25,174)
Cash and equivalents, beginning of year	89,231	114,405
Cash and equivalents, end of year	$ 88,107	$ 89,231

McMaster University, which operates by authority of The McMaster University Act, 1976, is governed by a Board of Governors (the Board) and Senate, the powers and responsibility of which are set out in the Act. It is a comprehensive research university offering a broad range of undergraduate, graduate and continuing education programs and degrees. The University is exempt from income taxes.

1. Significant accounting policies:

(a) Basis of presentation:

These financial statements include the accounts, transactions and operations for which the University has jurisdiction. They do not include the accounts, transactions and operations of the following entities which are independently governed and managed, and certain other related entities which carry out fundraising and other activities and are not material to these financial statements:

Independent entities:
- McMaster Divinity College
- McMaster Students Union, Inc.
- McMaster University Student Centre Incorporated
- McMaster Children's Centre, Inc.

Other entities:
- The McMaster University Trust
- The McMaster University Foundation
- The McMaster University Hong Kong Foundation
- Friends of McMaster Incorporated
- Directors College (50% joint venture)

The investment in the related entity, McMaster Innovation Park ("Park") is accounted for by the equity method (note 3). Since the Trusts which form the Park have fiscal year ends of December 31st, the University records its share of the operating results effective on that date (2006 - April 30, 2006).

(b) Revenue recognition:

The University follows the deferral method of accounting for contributions which include donations and government grants. The principles under this method are summarized as follows:

Unrestricted contributions are recognized as revenue when received or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured. Contributions pertaining to future periods are deferred and recognized as revenue in the year in which the related expenses are recognized.

Contributions externally restricted for purposes other than endowment and capital assets are deferred and recognized as revenue in the year in which the related expenses are recognized.

Contributions restricted for capital asset purchases are deferred and amortized to operations on the same basis as the related capital asset.

External endowment contributions and income preserved under the endowment capital protection policy [note 1(k)] are recognized as a direct increase in endowment net assets. Income earned from the investment thereof, to the extent it is allocated, is recorded as deferred contributions and recorded as revenue in the periods in which the related expenses are incurred.

Tuition fees which relate to academic terms or parts thereof occurring after April 30th are recorded as deferred revenue.

Gifts-in-kind are recorded at their fair market value on receipt, or at nominal value when fair market value cannot be reasonably determined.

Pledges from fundraising and other donations are recorded in the period in which they are collected.

1. Significant accounting policies (continued):

(c) Investments:

Investments with a term to maturity of 90 days or less on acquisition are included with cash and equivalents and are recorded at cost plus accrued income.

Long-term investments are carried at fair values. Changes in fair values are included in investment income.

Externally restricted investment income to the extent it is allocated is included with deferred contributions and recognized as revenue when the related expenses are incurred.

Unrestricted investment income is recognized as revenue during the period in which it is earned. Investment income from internal endowments is recorded as unrestricted revenue and transferred to internal endowments.

(d) Inventories:

Bookstore and nuclear reactor inventories are recorded at the lower of cost and net realizable value. Other inventories are recorded at cost.

(e) Capital assets:

Capital assets are recorded at cost, or if donated, at fair value on the date of receipt. Amortization is recorded on the straight-line basis at the following annual rates:

Buildings	2.5% to 10%
Decommissioning retirement costs	4%
Site improvements	5%
Library materials	10%
Computing systems	10%
Equipment, furnishings and vehicles	20%
Computing equipment	33.3%

(f) Collections and works of art:

The McMaster Museum of Art has significant collections of works of art and coins. Acquisitions and donations of works of art amounted to $125,000 (2006 - $124,000) and are charged to operations in the year of acquisition.

(g) Contributed services:

The University acknowledges the receipt of donated services. Because of the difficulty of determining their fair value, donated services are not recognized in the financial statements.

(h) Ancillary enterprises:

Ancillary enterprises are self-sustaining operations which fund their own replacements and renovations of equipment and facilities. Operating results are transferred annually from unrestricted net assets to specific purposes net assets.

1. Significant accounting policies (continued):

(i) Employee future benefits:

The University maintains separate defined benefit registered plans providing pension benefits for its salaried and hourly full-time employees. Additional pension benefits are provided through non-registered defined benefit plans. Other defined benefit plans provide non-pension, retirement and post-employment benefits for substantially all full-time employees.

For purposes of calculating expected returns on plan assets, registered pension plan assets are valued at a market related value (smoothed for the difference between actual and expected investment income over five years). The other pension and other post retirement and post-employment benefit plans are unfunded.

The costs of pension and other post retirement and post-employment benefits (primarily medical benefits and dental care) related to current service are charged to income. The current service cost and the accrued benefit obligation are actuarially determined for each plan using the projected benefit method prorated on service, and management's estimates of investment yields, salary escalation, health care trend rates and other factors.

The corridor method is used to amortize actuarial gains or losses over the average remaining service life of active employees. Under this method, amortization is recorded only if the accumulated net actuarial gains or losses exceed 10% of the greater of the beginning of year accrued benefit obligation and the actuarial value of the plan assets. Any past service costs arising from plan amendments are amortized on a straight-line basis over the expected average remaining service life of active employees.

A valuation allowance is recorded against an accrued benefit asset if the asset, less unamortized past service costs and unamortized actuarial losses, exceeds the present value of future service costs of the current active employees.

(j) Net assets:

Net assets are classified as follows:

Operating:

Unrestricted: operating funds available without specific restrictions.

Employee future benefits: pension and other non-pension retirement and post-employment benefits.

Specific purposes: as approved by the Board, unexpended departmental budgets carried forward for subsequent expenditures and other portions of net assets reserved for specific purposes.

Equity in capital assets: funds invested in capital assets, exclusive of capital assets financed through long-term debt or deferred capital contributions.

Internal endowments: unrestricted contributions including unspent investment income which have been restricted by action of the Board.

External endowments: external contributions, the principal of which is non-expendable pursuant to the restrictions by the donor, and income retained under the endowment capital protection policy.

1. Significant accounting policies (continued):

(k) Endowment capital protection policy:

In order to protect the capital value of endowment investments, an endowment capital protection policy limits the amount of investment income allocated for spending to 4% and requires the reinvestment of excess income.

Should endowment spending commitments exceed allocated income, amounts will be drawn from accumulated net investment income balances to fund deficiencies.

For endowments without sufficient accumulated investment income, temporary encroachment on capital is permitted. The encroached amounts will be recovered from future investment returns.

(l) Derivative financial instruments:

The University is party to certain interest rate swap agreements which are used to manage the exposure to fluctuations in interest rates. Payments and receipts under the agreements are recognized as adjustments to interest expense on long-term debt.

(m) Decommissioning obligation:

The fair value of a future asset retirement obligation is recognized when a legal obligation for the retirement of tangible long-lived assets is incurred and a reasonable estimate thereof can be determined. Concurrently, the associated decommissioning costs are capitalized as a part of the carrying amount of the asset and amortized over its remaining useful life.

The liability and the related asset may be adjusted periodically due to changes in estimates until settlement of the obligation.

(n) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the amounts of revenues and expenses.

Significant items subject to such estimates and assumptions include the carrying amount of capital assets, valuation allowances for receivables, valuation of derivative financial instruments, assets and obligations related to employee future benefits and the decommissioning obligation. Actual results could differ from those estimates.

(o) Future change in accounting policy:

Effective for the fiscal year commencing May 1, 2007, all financial assets and liabilities will be reflected at their fair values. In anticipation of the consequent reporting change, the University has elected to consider a substantial majority of its investments as held-for-trading.

2. Investments:

Details of investments are as follows:

(thousands of dollars)	2007		2006	
	Fair Value	Cost	Fair Value	Cost
Equities:				
Canadian	$ 121,524	$ 90,820	$ 111,137	$ 86,211
United States	103,581	93,190	94,771	99,714
Non-North American	118,004	98,142	101,248	91,405
	343,109	282,152	307,156	277,330
Fixed income	241,652	238,998	228,493	229,998
Other	3,637	3,770	2,463	2,464
	$ 588,398	$ 524,920	$ 538,112	$ 509,792

Included in investments are the following amounts (at fair value) restricted for:

(thousands of dollars)	2007	2006
Debt repayment sinking funds:		
Student residence mortgage	$ 4,422	$ 4,104
Debentures	10,524	9,469
Decommissioning obligation	6,325	5,622
	$ 21,271	$ 19,195

3. Investment in McMaster Innovation Park:

Details of the investment are as follows:

(thousands of dollars)	2007	2006
Balance, beginning of year	$ 13,460	$ 13,392
Advances in the year	-	100
Share in cumulative losses	(142)	(32)
Balance, end of year	$ 13,318	$ 13,460

The First Longwood Innovation Trust and The Gore District Land Trust were created by the University with the transfer of certain Trusts' assets and financial obligations effective January 1, and April 30, 2006. Along with their respective Trustee Corporations, their mission is to develop an entity for research, education, training, innovation and commercialization.

3. Investment in McMaster Innovation Park (continued):

Pertinent information from the Trusts' combined financial statements are as follows:

(thousands of dollars)	December 31 2006	April 30 2006
Total assets	$ 27,089	$ 27,412
Total liabilities	$ 103	$ 88
Total deferred revenue and capital grants	13,668	13,863
Total trusts' equity	13,318	13,461
	$ 27,089	$ 27,412
Results of operations:		
Total revenue	$ 1,910	$ 1,312
Total expenses	2,084	1,344
Loss for the period	$ (174)	$ (32)
Cash flows:		
Cash flows from operating activities	$ 1,508	$ 465
Cash flows from financing and investing activities	6,651	8,131
Increase in cash	$ 8,159	$ 8,596

Included in accounts payable and accrued liabilities is $6,821,156 (2006 - $8,454,000) owing to McMaster Innovation Park.

In addition to the information disclosed elsewhere, the University had the following related party transactions with the Trusts for their year ended December 31, 2006:

- provided management and administrative services without charge;
- paid rent in the amount of $86,400;
- charged for project management services amounting to $50,700;
- exchanged construction fill materials at nominal values.

4. Capital assets:

(thousands of dollars)	Cost	Accumulated amortization	2007 Net
Land	$ 3,494	$ -	$ 3,494
Buildings	615,850	203,581	412,269
Decommissioning costs	213	17	196
Site improvements	6,412	5,220	1,192
Library materials	116,163	82,884	33,279
Equipment, furnishings and vehicles	283,628	211,908	71,720
Computing systems and equipment	100,732	76,128	24,604
Construction in progress	67,058	-	67,058
	$ 1,193,550	$ 579,738	$ 613,812

4. Capital assets (continued):

(thousands of dollars)	Cost	Accumulated amortization	2006 Net
Land	$ 3,477	$ -	$ 3,477
Buildings	525,165	189,286	335,879
Decommissioning costs	213	9	204
Site improvements	6,412	5,129	1,283
Library materials	111,367	76,672	34,695
Equipment, furnishings and vehicles	261,259	187,849	73,410
Computing systems and equipment	110,461	84,408	26,053
Construction in progress	95,841	-	95,841
	$ 1,114,195	$ 543,353	$ 570,842

5. Employee future benefits:

The accrued benefit obligations as determined by independent actuaries and the fair values of the plans' assets are recorded as at April 30th.

(a) Information on the aggregate defined benefit plans position is as follows:

(thousands of dollars)	2007		
	Pension		
	Registered	Supplemental	Other
Accrued benefit obligation	$ 1,120,536	$ 65,312	$ 223,300
Fair value of plan assets	1,087,007	-	-
Funded status - deficiency	(33,529)	(65,312)	(223,300)
Reconciliation to deferred benefits (accrued future benefits):			
Unamortized past service cost	(3,716)	1,002	-
Unamortized actuarial loss	260,217	2,828	102,131
Deferred pension asset (accrued employee future benefits)	$ 222,972	$ (61,482)	$ (121,169)

(thousands of dollars)	2006		
	Pension		
	Registered	Supplemental	Other
Accrued benefit obligation	$ 994,538	$ 65,365	$ 184,157
Fair value of plan assets	967,460	-	-
Funded status - deficiency	(27,078)	(65,365)	(184,157)
Reconciliation to deferred benefits (accrued future benefits):			
Unamortized past service cost	148	-	-
Unamortized actuarial loss	252,339	2,740	80,969
Deferred pension asset (accrued employee future benefits)	$ 225,409	$ (62,625)	$ (103,188)

Each of the plans included above has accrued benefit obligations in excess of the fair value of plan assets at April 30th.

5. Employee future benefits (continued):

(b) Information on the net benefit expense is as follows:

(thousands of dollars)	2007		2006	
	Pension	Other	Pension	Other
Net benefit expense	$ 41,941	$ 22,235	$ 36,555	$ 20,494

(c) Information on the pension plan assets includes the following:

	Percentage of fair value of total plan	Target allocation percentage	Expected long-term rate of return
Equity securities	68%	65%	8.3%
Debt securities	31.5%	35%	4.6%
Other	0.5%	0%	3.0%

(d) The significant actuarial assumptions adopted in measuring the accrued benefit obligations are as follows:

	Pension	Other
Discount rate	5.3%	5.25%
Expected long-term rate of return on plan assets	7.0%	n/a
Rate of compensation increase	4.5%	4.5%

(e) The significant actuarial assumptions adopted in measuring the net benefit expense are as follows:

	Pension	Other
Discount rate	5.5%	5.75%
Expected long-term rate of return on plan assets	7.0%	-
Rate of compensation increase	4.5%	4.5%

(f) Details of annual contributions and benefits paid are as follows:

(thousands of dollars)	2007		2006	
	Pension	Other	Pension	Other
Employer contributions	$ 40,646	$ 4,254	$ 23,449	$ 3,923
Employee contributions	10,539	-	8,993	-
Benefits paid	49,083	4,254	41,837	3,923

(g) For measurement purposes, a 10% annual rate of increase of the 2004 per capita medical cost was assumed. The rate was assumed to decrease to 8.6% in 2007 grading down to 5% per annum in and after 2015. For dental, 5% per annum for determination of accrued benefit obligation as at April 30, 2006, and 4% per annum thereafter were assumed.

5. Employee future benefits (continued):

(h) Details of actuarial valuation completion for funding purposes and filing dates of the respective plans are as follows:

- hourly rated employee pensions: completed as at July, 2004; the next required filing date is July, 2007.
- all other employees pension benefits: completed as at July, 2006; the next required filing date is July, 2009.
- other benefit: completed as at May, 2007.

The results of each valuation have been extrapolated to April 30, 2007, which is the measurement date used to determine the accrued benefit obligation for all employee future benefit plans.

6. Long-term obligations:

Details of long-term obligations are as follows:

(thousands of dollars)	Maturity	Interest Rate	Current portion	Non-current portion	2007 Total Outstanding	2006 Total Outstanding
Residence mortgage (a)	May 2011	9.81%	$ -	$ 11,544	$ 11,544	$ 11,544
Bank loan (b)	Dec 2012	floating	536	2,992	3,528	4,032
Mortgage	Oct 2016	5.38%	91	1,008	1,099	1,186
Bank term loan (c)	May 2033	floating	310	19,784	20,094	20,384
Debentures (d)	Oct 2052	6.15%	-	120,000	120,000	120,000
			937	155,328	156,265	157,146
Decommissioning obligation (e)			-	5,427	5,427	5,163
			$ 937	$ 160,755	$ 161,692	$ 162,309

Principal payments due in each of the following five years are as follows (in thousands of dollars):

2008	$ 937
2009	997
2010	1,060
2011	1,128
2012	12,744

(a) A sinking fund (note 2) has been established to fund a portion of the principal repayment of the residence mortgage upon maturity. Increases to the fund are charged to residence ancillary operations. The value of the fund amounts to $4,422,000 (2006 - $4,104,000).

(b) The bank loan maturing in 2012 is unsecured and the outstanding amount is subject to a 10-year interest rate swap agreement on an original notional principal of $5,500,000 with the banker whereby the University receives a floating interest rate while paying a fixed rate of 6.25%.

The fair value of the agreement as at April 30, 2007 was in a net unfavourable position amounting to $158,582 (2006 - $191,140) and was based on amounts quoted by the University's banker.

(c) The bank term loan is unsecured and is being amortized over 30 years. The outstanding loan amount is subject to a 30 year interest rate swap agreement on an original notional principal of $20,954,441 with the banker whereby the University receives a floating interest rate while paying a fixed (10 year) rate of 6.384%.

The fair value of the agreement as at April 30, 2007 was in a net unfavourable position amounting to $3,726,884 (2006 - $3,163,401) and was based on amounts quoted by the University's banker.

6. Long-term obligations (continued):

(d) The debentures, which are unsecured, bear interest at 6.15% payable semi-annually in April and October. The proceeds of the issue are being used to finance various capital projects.

A sinking fund (note 2) has been established to provide funds to repay the debenture principal upon maturity. Increases to the sinking fund are charged to operations. The value of the fund amounts to $10,524,000 (2006 - $9,469,000).

(e) It is expected that the nuclear reactor will be decommissioned at some undeterminable future date. Under an agreement with the Canadian Nuclear Safety Commission (CNSC), a trust fund has been established which requires annual funding contributions to provide for the decommissioning costs.

As at April 30, 2007, the fair value of the trust funds amounted to $6,325,000 (2006 - $5,622,000) (note 2). In total, the net present value of the estimated cost for decommissioning, at April 30, 2007 is $5,427,000 (2006 - $5,163,000) using a risk free rate of 5.10%.

7. Deferred contributions:

(a) Deferred for future expenses:

Deferred contributions represent external contributions restricted for research and trust expenses to be incurred in subsequent fiscal years. Details of the change in deferred contributions are as follows:

(thousands of dollars)	2007	2006 (note 17)
Balance, beginning of year	$ 203,877	$ 209,743
Deferred and capital contributions received	240,859	230,542
	444,736	440,285
Less:		
Amounts recognized as revenue	(188,767)	(180,223)
Deferred capital contributions transfer	(44,595)	(41,185)
Contribution to McMaster Innovation Park	-	(15,000)
Balance, end of year	$ 211,374	$ 203,877

Deferred contributions consist of the following:

(thousands of dollars)	2007	2006
Research grants and contracts	$ 144,020	$ 136,022
Donations, other grants and investment income	53,273	55,881
Capital grants and donations	9,872	10,704
Other restricted funds	4,209	1,270
	$ 211,374	$ 203,877

7. Deferred contributions (continued):

(b) Deferred capital contributions:

Deferred capital contributions represent the unamortized amount of donations and grants received for the purchase of capital assets. Unspent deferred capital contributions are included in deferred contributions for future expenses until such time as capital expenditures are incurred. Details of the change in the unamortized deferred capital contributions are as follows:

(thousands of dollars)	2007	2006
Balance, beginning of year	$ 284,591	$ 284,159
Add contribution transfers	53,473	41,185
Less amount amortized to revenue	(38,268)	(40,753)
Balance, end of year	$ 299,796	$ 284,591

8. Internally restricted net assets:

Details of internally restricted net assets (deficiency) are as follows:

(thousands of dollars)	2007	2006
Employee future benefit related:		
Pensions	$ 121,242	$ 128,542
Other retirement and post employment benefit plans	(111,847)	(94,804)
	9,395	33,738
Specific purposes:		
Unexpended departmental carryforwards	49,527	40,929
Other	39,958	27,904
	89,485	68,833
Capital projects	(32,770)	(22,947)
	56,715	45,886
	$ 66,110	$ 79,624

Included in unexpended departmental carryforwards is a $6,000,000 (2006 - $6,000,000) advance to the Faculty of Science from unrestricted net assets for which arrangements for recovery have been established.

Details of the internally financed capital projects which have various recovery terms and periods are as follows:

Project	Funding Source	Balance (thousands of dollars)
Les Prince Residence	Ancillary operations	$ (20,191)
David Braley Athletic Centre	Student levies, pledges, fundraising	(8,104)
Stadium and Parking Project	Parking fees, pledges, fundraising	(8,637)
Residence Wiring Project	Ancillary operations	(1,572)
McMaster Biosciences Incubation Centre	Rental and other income	(1,208)
Other projects (net)	Various	6,942
		$ (32,770)

9. Equity in capital assets:

The equity in capital assets is calculated as follows:

(thousands of dollars)	2007	2006
Capital assets	$ 613,812	$ 570,842
Less amounts financed by:		
Net long-term debt	(136,964)	(136,152)
Unamortized deferred capital contributions	(299,796)	(284,591)
	$ 177,052	$ 150,099

Details of the transfer for capital transactions are as follows:

(thousands of dollars)	2007	2006
Repayment of long-term debt	$ 881	$ 828
Change in sinking funds and other	1,389	1,489
Capital asset purchases from operating	48,845	57,784
	$ 51,115	$ 60,101

10. Endowments:

(a) Internal:

Details of the change in internally restricted endowments are as follows:

(thousands of dollars)	2007	2006
Balance, beginning of year	$ 143,878	$ 131,515
Donations	280	563
Investment income	15,723	18,874
Net transfers and expenses	(5,058)	(7,074)
Balance, end of year	$ 154,823	$ 143,878

Included in internal endowments is an amount of $65,922,000 (2006 - $61,967,000) reflecting the legacy of Dr. H. L. Hooker. The income generated from this capital is used to fund programs that enrich the academic achievements of the University as approved annually by the Board.

(b) External:

Details of the change in externally restricted endowments are as follows:

(thousands of dollars)	2007	2006
Balance, beginning of year	$ 249,481	$ 204,640
External contributions:		
OTSS	4,520	6,760
Other	17,666	15,727
Income retained for capital protection	18,753	21,854
Transfer from internal endowments	-	500
Balance, end of year	$ 290,420	$ 249,481

11. Commitments and contingencies:

(a) Canadian Universities Reciprocal Insurance Exchange:

The University is a member of the Canadian Universities Reciprocal Insurance Exchange (CURIE), a self-insurance cooperative comprised of over forty Canadian universities and colleges. CURIE insures property damage, general liability and errors and omissions risks. If premiums collected are insufficient to cover expenses and claims, the University may be requested to pay additional amounts.

(b) Legal claims:

The University is involved in certain legal matters and litigation in the normal course of operations, the outcomes of which are not presently determinable. The loss, if any, from these contingencies will be accounted for in the periods in which the matters are determined. Management is of the opinion that these matters are mitigated by adequate insurance coverage.

On October 12, 2007, the University was served with a Class Action claim (“Claim”) by Clinical Faculty members who participated in the Pension Plan for Salaried Employees (“Plan”) during the period from 1973 to date. The basis of the Claim, which amounts to $31 million approximately, relates to allegations of certain breaches of trust and fiduciary responsibilities in the administration of the Plan. The outcome of this matter is not determinable and provision has not been made for costs, if any, under the Claim in the financial statements.

(c) Capital commitments:

The estimated cost to complete approved major capital projects amounted to $103,350,000 at April 30, 2007 (2006 - $99,700,000).

(d) Leases:

The University has entered into operating lease agreements for office equipment and buildings. The total annual minimum lease payments in each of the next five years are approximately as follows:

(thousands of dollars)		
2008	$	3,950
2009		3,950
2010		3,730
2011		2,990
2012		1,970

11. Commitments and contingencies (continued):

(e) Faculty Retirement Incentive Program:

Pursuant to a Board Resolution dated March 1, 2007, the University initiated a Faculty Retirement Incentive Program (“Program”) which provides for the voluntary retirement of 180 eligible academic faculty subject to the approval of the relevant Dean and Provost. The Program provides for an incentive of one month salary for each year of employment to a maximum of 12 months, up to an aggregate total of $7 million.

Since there were no applications approved as at April 30, 2007, provision has not been made in the financial statements for any costs related to the Plan. As at August 3, 2007, 49 faculty members had applied and were approved.

12. Related party transactions:

In addition to transactions and balances with the related entity as disclosed in note 3, the University had the following transactions with:

- Fundraising entities: funds received during the year amounted to $327,000 (2006 - $341,000).
- Joint venture: the University's share of income (loss) amounted to ($12,000) (2006 - $75,000).

13. Ontario student opportunity trust fund:

External endowments include grants for funding student aid provided by the Government of Ontario's Student Opportunity Trust Fund matching program. Under the program, the Province has matched qualifying external endowment donations received with equal contributions.

(a) Ontario Student Opportunity Trust Fund - Phase I

The following schedule represents the changes for the years ended April 30, 2007 and 2006 in the first phase of the Ontario Student Opportunity Trust Fund (OSOTF I) balance:

(thousands of dollars)	2007	2006
Endowment balance, beginning of year	$ 32,515	$ 31,670
Investment income retained for protection of capital	(228)	977
Investment income transferred to expendable income	(143)	(132)
Endowment balance, end of year	32,144	32,515
Funds available for awards, beginning of year	-	-
Investment income	1,083	1,074
Bursaries awarded (2007 - 985 awards; 2006 - 892 awards)	(1,226)	(1,206)
Investment income transferred from endowment balance	143	132
Funds available for awards, end of year	-	-
Total funds at book value	$ 32,144	$ 32,515

The market value of the endowment as at April 30, 2007 was $35,508,000 (2006 - $33,393,000).

13. Ontario student opportunity trust fund (continued):

(b) Ontario Student Opportunity Trust Fund - Phase II

The Ontario government requires separate reporting of balances as at April 30, and details of the changes in the balances for the period then ended with respect to the second phase of the Ontario Student Opportunity Trust Fund (OSOTF II) of McMaster University including Divinity College.

The following is the schedule of changes for the year ended April 30, 2007 and the thirteen months ended April 30, 2006:

(thousands of dollars)	2007	2006
Endowment balance, beginning of year	$ 5,989	$ 6,579
Unmatched cash donations transferred to OTSS	-	(1,010)
Investment income retained for protection of capital	(22)	420
Endowment balance, end of year	5,967	5,989
Funds available for awards, beginning of year	13	82
Investment income for expenditures	158	140
Bursaries awarded (2007 - 123 awards; 2006 - 177 awards)	(153)	(209)
Funds available for awards, end of year	18	13
Total funds at book value	$ 5,985	$ 6,002

The market value of the endowment as at April 30, 2007 was $6,369,000 (2006 - $5,937,000).

14. Ontario trust for student support:

The Ontario government has initiated a student assistance program (Ontario Trust for Student Support (OTSS)) whereby it will provide an equivalent matching contribution for external endowment contributions made to the program to a specified ceiling. Pursuant to the program requirements, separate disclosures are required as at March 31st of the changes in the fund balances, the details of which are as follows.

The following is the schedule of donations received for the years ended March 31, 2007 and 2006:

(thousands of dollars)	2007	2006
Cash donations eligible for matching	$ 2,075	$ 1,739
Unmatched cash donations transferred from OSOTF II	-	1,010
Eligible for matching	2,075	2,749
Unmatched cash donations	860	1,830
Cash donations total	$ 2,935	$ 4,579

14. Ontario trust for student support (continued):

Certain cash donations received are eligible for matching by the Ministry of Training, Colleges and Universities (MTCU). The following is the schedule of changes in the endowment balance and expendable funds for awards for the years ended March 31, 2007 and 2006:

(thousands of dollars)	2007	2006
Endowment balance, beginning of year	$ 7,407	$ -
Cash donations received with annual matching ceiling	2,935	4,579
Funds received/receivable from MTCU	2,075	2,749
Investment income retained for protection of capital	71	79
Endowment balance, end of year	12,488	7,407
Funds available for awards, beginning of year	68	-
Investment income for expenditures	373	101
Bursaries awarded (2007 - 78 awards; 2006 - 22 awards)	(122)	(33)
Funds available for awards, end of year	319	68
Total funds at book value	$ 12,807	$ 7,475

15. Pledges receivable:

Outstanding but unrecorded pledges for donations and other fund raising amounted to $39,284,000 (2006 - $60,594,000).

16. Fair value of financial instruments:

The carrying values of cash and equivalents, government grants and other accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of these items or because of the current nature of the terms on these instruments.

Information concerning the fair value of investments is disclosed in note 2.

In view of the relationships and the nature of the instrument, the fair value of the investment in McMaster Innovation Park is not determinable.

The fair values of the respective long term obligations are presented in the following table:

(thousands of dollars)	2007		2006	
	Book Value	Fair Value	Book Value	Fair Value
Long term debt:				
- with fixed interest rates	$ 132,643	$ 164,602	$ 132,730	$ 151,438
- with variable interest rates (without consideration of interest rate swaps)	23,622	23,622	24,416	24,416

The fair value of these obligations was calculated using the future cash flows (principal and interest) of the actual outstanding debt instruments, discounted at current market rates available to the University for similar instruments.

Information concerning the fair values of the interest rate swap agreements is disclosed in notes 6(b) and 6(c).

17. Comparative figures:

The University reviewed its interpretation for the calculation for the retention of investment income in connection with its Endowment Capital Protection Policy. This calculation is now made based on total investment income. This adjustment, which has been applied retroactively, resulted in the following restatements:

- Decrease in deferred contributions for future expenses and corresponding increases in external endowment net assets and total net assets respectively of $4,312,000;
- Decrease in investment income and a corresponding increase in donations and other grants respectively of $4,312,000.

Certain comparative figures for 2007 have been reclassified to conform with the financial presentation adopted in the current year.

McMaster University
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