

Annual Financial Report 2008/2009





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“At McMaster
our purpose is
the discovery,
communication
and preservation
of knowledge.”

Peter George
President and Vice-Chancellor,
McMaster University

Measuring our Performance — 2008/09

Executive Summary

McMaster University is one of Canada's leading student-centered, research intensive institutions. This reputation is recognized internationally. The successes of the past year include expansion of teaching and research programs, growth in the number of international and out-of-province student applications and a continued level of fundraising success. Major accomplishments in 2008/09:

ACCOMPLISHMENTS

- Met enrolment targets (growth of 2.4% over 2007/08) and increased entering average
- Rated among the very best in the country when it comes to having the most satisfied students and offering high quality education and teaching (Globe and Mail University Report Card)
- Ranked as one of the Top 100 universities in the world (Shanghai Jiao Tong University ranking of world universities)
- Placed 3rd in the 2008 Research Infosource Inc. university rankings for 'research intensity' and 6th for 'its ability to capitalize on research income'
- Broke ground in Halton Region for the Ron Joyce Centre at the DeGroote School of Business, the new home of McMaster's MBA Program and executive education initiatives
- Began construction at McMaster's Innovation Park on the federal CANMET Materials Technology Laboratory (CANMET-MTL), which is relocating to Hamilton from Ottawa.
- Participated in more than 40 exchange agreements around the globe

These achievements were made during a period of financial market turmoil, which has tilted the delicate balance of university finances to one of increasing concern. Investment losses, both in endowment funds and pension plans, led to the loss of critical investment income and increased the University's considerable future financial obligations. These factors, in combination with the ongoing uncertainty of government grant allocations and tuition regulations, and continuing inflationary cost pressures mean that the University's financial position will continue to be challenged.

These challenges threaten the operating funding for core academic and research missions. Absent a combination of substantial improvements in financial markets, revenue growth, cost reductions and relief of pension funding obligations, there is no doubt that the university's operating budget will be under tremendous pressure over the next few years. Left unaddressed, these pressures will affect important initiatives in the core missions. Graduate program growth, faculty renewal, quality improvements, reasonable class sizes, and support for research initiatives, all critical components of our strategy, will inevitably be affected.

Actions already taken to tackle the emerging challenges include:

ACTIONS

- Developing compensation strategies to limit future growth in pension and post-retirement benefit liabilities. Senior academic and administrative officers took a leadership position and the strategies have been successfully negotiated with several employee groups and their representatives.
- Restricting income spent or transferred from endowments to allow funds to recover from the severe market downturns. The loss of investment income in 2008/09 required the University to use earnings previously preserved under its endowment policy to support trust fund and operating expenditures. In 2009/10, policies have been put in place to further constrain expenditures from endowment funds in order to allow “underwater” funds (those whose market value has fallen below the original donated capital) to recover.
- Exercising operating budget controls in the form of vacancy management, expense deferrals and cost containment, which enabled the operating fund (which excludes the accrued pension and non-cash post-retirement benefit costs) to be balanced. The operating fund (which accounts for over 56% of total expenditures) experienced a surplus of \$8.0 million or 1.8% of revenue (2007/08 – \$9.9 million).
- Strengthening project prioritization and capital spending policies to ensure that capital resources are dedicated to strategic priorities.

The audited financial statements of the University provide the results of all funds and report a \$53.9 million deficit (2007/08 - \$13.5 million deficit). In 2008/09, revenues were essentially flat in aggregate due to the impact of the loss of investment income. Total revenue per full time equivalent (FTE) student declined by 2.6% to \$30,400. Led by salary and benefit costs, expenses continued to grow faster than revenue necessitating cost reduction strategies. Pension deficit and post-retirement benefit costs exacerbated this situation. As a result, operating net assets declined to \$9.8 million (2007/08 - \$57.6 million). Reflecting primarily valuation losses on endowment funds, net assets declined by 16.3% to \$574 million and endowment per FTE student dropped by 16.8% to \$17,300. The University did not increase external debt in 2008/09. However, internal loans to fund capital building projects increased significantly during the year and an additional \$19.8 million was invested in capital projects through internal loans.

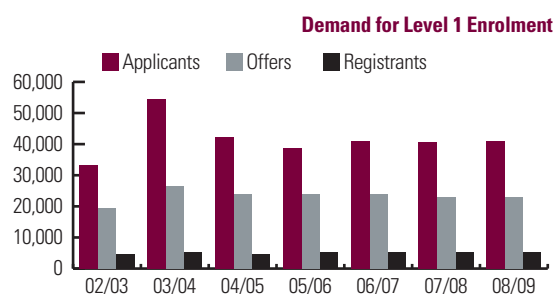
The financial situation prompts the question: will the University’s current strategies support its sustainability? The review performed by the credit rating agencies this past year resulted in the maintenance of a AA rating; however DBRS re-confirmed its trend from ‘stable’ to ‘negative’ based on the declining operating results, indication for increased debt and the rising post-retirement benefit costs. The University has developed plans and strategies to address each of these areas. Difficult decisions have been and must continue to be made in order to deliver the core academic and research missions in a financial environment that provides limited, if any, flexibility and discretion. The task forces established to focus on the implementation of the Refining Directions strategic plan will continue to provide advice to support these decisions. Among these, the President’s Advisory Committee on the Impacts of the Current Economic Situation (PACICES) has been charged with the responsibility of developing strategic advice and recommending strategies to the President to ensure the long term sustainability of the University. This taskforce issued an interim report in October 2009. Additional taskforces are underway to address important enterprise risks that extend beyond financial risk, eg. technology. An updated technology strategy is in development.

The University will continue to focus attention on revenue generation, control of total compensation costs and strategic deployment of resources to improve its financial health. It will also maintain, both as McMaster and as a member of associations, continued active dialogue with the Province of Ontario and the Federal Government on the funding pressures facing universities and the steps necessary to ensure that McMaster can deliver on its core missions during a period of increasing demand and declining revenues.

2008/09 Key Financial Indicators

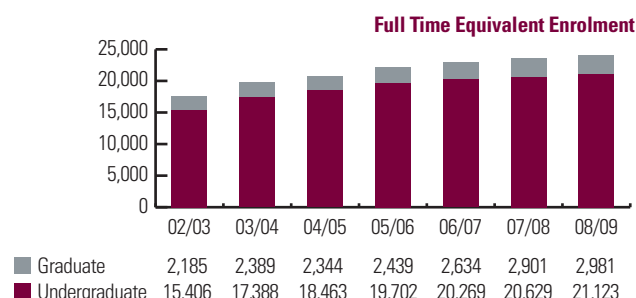
Achieve Strong Demand for Programs

- the number of applications increased slightly from 40,607 to 41,133 (1.3%)
- the percentage of students who accepted McMaster offers decreased marginally from 23.4% to 23.0%, but remained above the 5 year average of 22%
- the proportion of students naming McMaster as their first choice declined slightly to 7.3% (2007/08 – 7.6%)



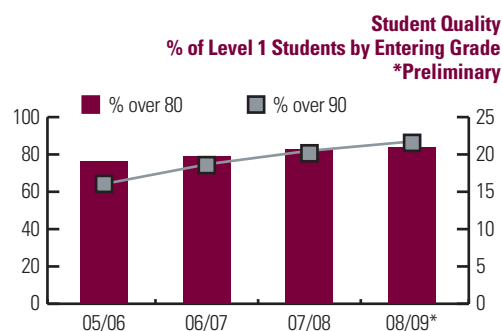
Achieve Targeted Enrolment Levels

- 2.4% increase in total full time equivalent (FTE) enrolment (574 additional FTE)
- FTE enrolment was ahead of target by 1.5%
- 2.4% growth in undergraduate students, and 2.8% growth in graduate students



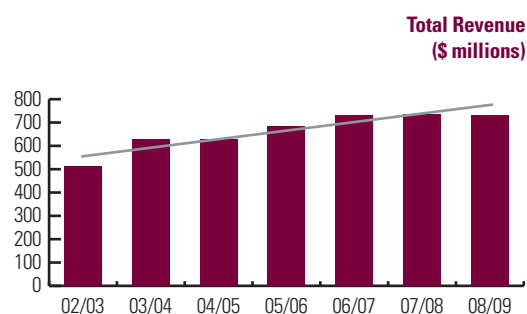
Attract Students with High Academic Standing

- average entering grade increased from 83.5% to 84.9% in the past 4 years (as calculated on best six courses)
- % of level 1 students with an entering average greater than 80 increased to 83.7% (2007/08 – 82.7%)
- % of level 1 students with an entering average greater than 90 increased to 21.2% (2007/08 – 19.9%)



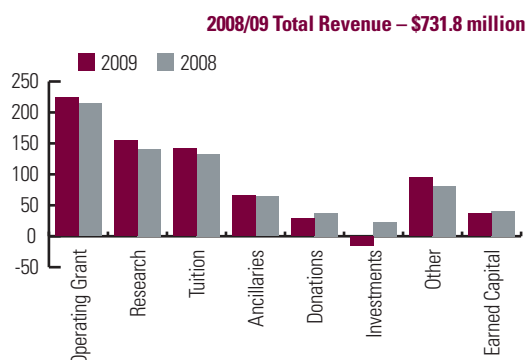
Increase the Revenue Base

- \$3.2 million (0.4%) decrease in total revenue reflects the investment loss offset by increased tuition and grant income
- revenue \$731.8 million has grown by 16.3% over the past five years from \$629.4 million in 2003/04
- revenue per FTE at \$30,400 declined from \$31,200 in 2007/08



Diversify the Revenue Base

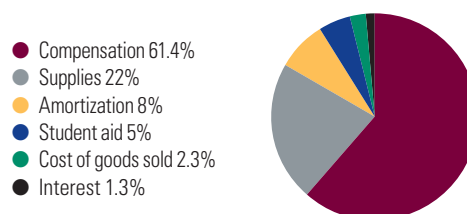
- well-diversified revenue base reduces dependency on any one source, however, the investment loss in 2008/09 had a significant overall impact
- most of other categories of revenue increased including grants, research income and tuition



Strategic Deployment of Resources

- expenses increased as a result of increased research spending and compensation costs
- total compensation expenses increased by \$14.2 million
- the proportion of total expenditures for compensation declined to 61.4% (2007/08 – 62.8%)
- the proportion of total expenditures used for supplies increased to 22.0% (2007/08 – 19.2%)

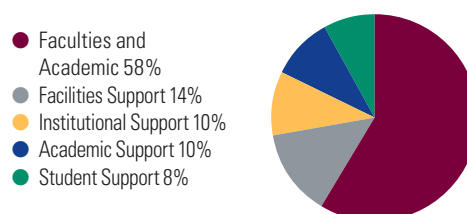
2008/09 Total Expenses
\$785.8 million



Strategic Deployment of Resources

- 58% of operating expense is invested into Faculty and Academic Priority budget envelopes (2007/08 – 57%)
- the proportion of operating expenditures for institutional support declined to 10% (2007/08 – 11%)

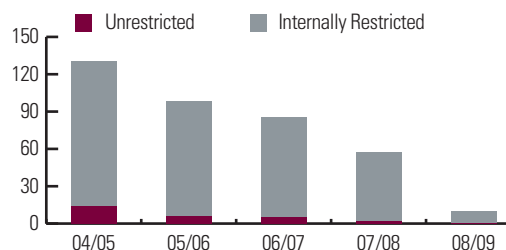
2008/09 Operating Fund Net Expenditures by Envelope
\$349.8 million



Financial Position

- \$48.0 million decrease in total operating net assets
 - \$23.6 million decrease in specific purpose reserves primarily as a result of an increase in internal loans of \$19.8 million used to support core building projects
 - increases in employee future benefit deficiency of \$22.4 million

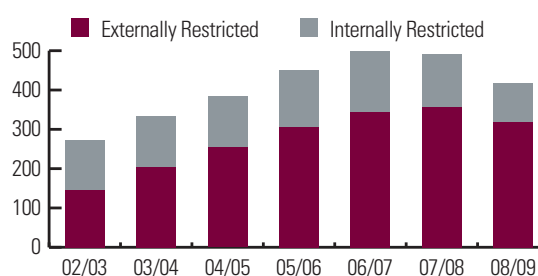
Operating Net Assets \$9.8 million
(\$ millions)



Financial Position

- endowment per FTE student of \$17,300 decreased due to investment losses
- external endowments (including deferred donations) decreased by 10.8% (\$38.6 million)
- net investment loss of 18.9% on long term investment pool (2007/08 – (0.1%))

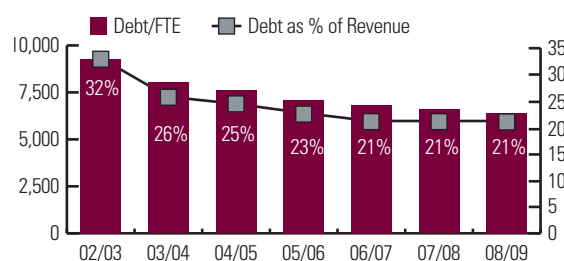
Endowment Funds (Market value \$417.1 million)



Manage Business Risks

- long term debt of \$154.3 million decreased slightly
- long term debt per student at \$6,401 decreased (2007/08 – \$6,600)
- a total of \$68.9 million (\$2,858 per FTE) of capital project debt was financed internally (2007/08 – \$49.1 million)
- voluntary sinking funds of \$13.3 million of which \$8.2 million (2007/08 – \$10.4 million) is available to repay the \$120 million debenture in 2052

Long Term Debt Ratios





“We inspire
critical thinking,
personal growth
and a passion
for lifelong
learning.”

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 two 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 decade.

Over the course of the last two academic years, a number of new committees and task forces were established to focus the implementation of *Refining Directions*.

- *Refining Directions Implementation Plan Committee*
 - will focus on how to further implement *Refining Directions* and guide the establishment of priorities to achieve its goals
- *Task Force on Teaching and Learning (TOTAL)*
 - will determine the current state of teaching and learning on our campus, identify goals and design implementation and evaluation strategies
- *Task Force on Evaluation, Accountability, and Measurement (TEAM)*
 - will develop strategies for evaluating various academic and service units on our campus
- *Alternative Budget Model Committee*
 - will recommend a new budget allocation model to better align budgeting with our strategic goals
- *International Activities Committee*
 - will develop a compendium of our international activities and recommend strategies moving forward



Financial Management

At the institutional 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*. At the present time, the budget methodology and process are undergoing a complete review to ensure that there is alignment of the budget model with the strategic goals of the University.

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

1. to achieve strong demand for programs and consistently achieve student enrolment targets
2. to increase and diversify the revenue base
3. to strategically deploy resources into priority areas
4. 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 included above. The actual results are analyzed 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, particularly in the current environment. The economic downturn has had an immediate and significant impact on the University and there is concern that the 2009/10 fiscal period will have an even greater negative impact. It is the operating budget that is most challenged by the impact of declining revenues and increasing costs. Finding new ways to balance the budget by focusing on plans that respect the fiscal challenges while making investments in strategies that further the achievement of the *Refining Directions* goals remains a top priority.

“ We serve the social, cultural and economic needs
of our community and our society. ”

Key Financial Indicator 1

Achieve Strong Demand for Programs

In 2008/09, the University expected that undergraduate enrolment would be constant, while graduate enrolment would continue to grow. In total, full time equivalent (FTE) enrolment in 2008/09 increased 2.4% over the previous year as a result of growth in both undergraduate and graduate students. The increase in FTE enrolment was made up of a 2.4% increase in undergraduate enrolment and a 2.8% increase in graduate enrolment.

The number of applications to McMaster programs increased by 1.3%. The percentage of students who accepted McMaster decreased marginally to 23.0% (2007/08 – 23.4%), still above the University's five-year average of 22%.

McMaster continues to attract a robust applicant pool with regards to both quality and quantity, and has achieved its commitment to enhancing the entering average of the Level 1 class. In 2008/09,

McMaster achieved the following improvements in student quality:

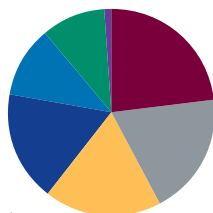
- The average entry grade for students increased to 84.9% (2007/08 – 84.6%) as calculated on the best six courses, and reported in the Canadian University Data Ontario report (CUDO).
- McMaster's percentage of Level 1 students with an entering average of greater than 80% increased to 83.7% (2007/08 – 82.7%).
- The percentage of Level 1 students entering with an average grade over 90% increased to 21.2% (2007/08 – 19.9%).

Student enrolment in 2008/09 continues to be well distributed through the University's six faculties.

Looking forward to 2009/10, preliminary figures indicate that first year undergraduate enrolment will remain relatively constant. Graduate enrolment continues to increase in line with the growth plans approved by the Ministry.

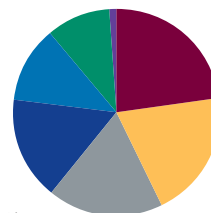
2008/09 FTE Enrolment
24,104 FTEs

- Science 24%
- Health Sciences 19%
- Social Sciences 18%
- Engineering 17%
- Humanities 11%
- Business 10%
- Arts & Science 1%
- Divinity & Interdisciplinary 0%



2007/08 FTE Enrolment
23,530 FTEs

- Science 23%
- Social Science 20%
- Health Sciences 18%
- Engineering 16%
- Humanities 12%
- Business 10%
- Arts & Science 1%
- Divinity & Interdisciplinary 0%



1 FTE is calculated as the number of full time students plus (part-time enrolment/3.5)

Key Financial Indicator 2

Increase and Diversify Revenues

In 2008/09, the University was unable to achieve its goal of increasing its annual revenues due to the loss from investments. Revenues decreased from \$735.0 million in 2007/08 to \$731.8 million (0.4%). Translated into revenue per FTE enrolment of \$30,400, this is 2.6% lower than 2007/08. This decrease in per student funding highlights the challenge to provide for a quality education experience and cover inflationary costs without the implementation of further budget reduction strategies.

Operating Grants Income

Government operating grants of \$208.7 million increased by \$8.8 million or 4.4% over 2007/08 grants of \$199.9 million. Increases to MTCU funding continue to be tied to specific performance outcomes such as increasing enrolment. Accessibility (undergraduate growth) and Graduate Expansion funding is received based on each University's share of the year over year growth, and represents \$5.6 million of the increase over 2007/08. This amount included an increase to the per-unit funding rate and full funding for all students on a one-time basis. Additional one-time Quality and Sustainability Grants totaling \$3.7 million were received. These one-time funds are not expected to recur in 2009/10 and will not be available to cover ongoing expenditures.

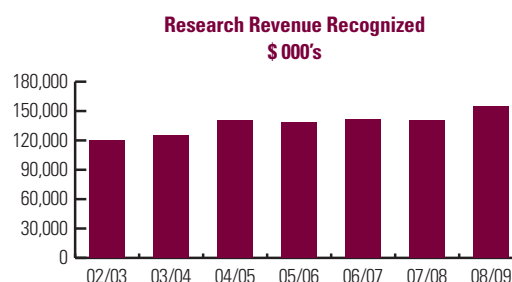
Research Grants and Contracts

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. Before allowing for deferrals, \$174.2 million (2007/08 - \$179.1 million)

was received for future use. After deferrals, research revenue recognized over the past year has increased by 10.0% to \$154.7 million (2007/08 - \$140.6 million).

	\$ millions	
RESEARCH REVENUE RECOGNIZED	2009	2008
Federal Government	100.2	103.9
Province of Ontario	16.6	9.2
Other sources	57.4	66.0
Total research funds received	174.2	179.1
Less: amount deferred to future	(19.5)	(38.5)
	154.7	140.6

The revenue recognized by the University does not include hospital research, or funding for Networks of Centres of Excellence such as the Centre for Probe Development and Commercialization hosted by McMaster University. However, these related ventures also reflect McMaster's success in creating internationally recognized centres of research excellence, building the infrastructure to support strategic research areas and integrating scholarship with teaching.



Despite the competition among Canadian universities for research funding, future prospects for increased growth remain strong. In the 2008 rankings of Canada's top 50 research universities by Research Infosource Inc., McMaster ranked third (2007/08 – 2nd) in research intensity and sixth (2007/08 – sixth) in its ability to capitalize on its research income.

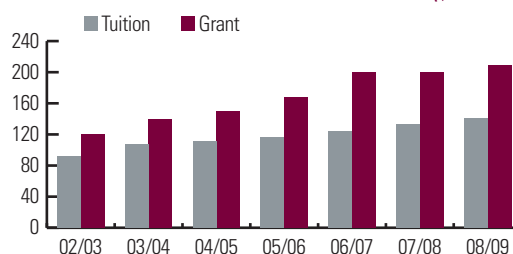
Research Overhead Grants

Research overhead grants assist the University in funding the indirect costs of research. In 2008/09, \$15.6 million was received (2007/08 – \$14.6 million). The Province and the Federal Government fund a portion of overhead costs associated with the federal research granting councils and eligible provincial research programs.

Tuition Fees

Revenue from tuition fees has increased by 6.5% in 2008/09 as a result of a 2.4% 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 2008/09, the University increased fees by the maximum allowable increase for each regulated program. The ratio of tuition-to-grant revenue has increased in 2008/09 as a result of the increase in both the number of students and average fee per student.

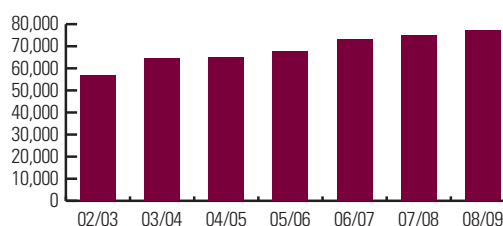
Historical Perspective on Operating Grant vs Tuition Income (\$ millions)



Ancillary Operations

Ancillary operations have a mandate to provide excellent services and operate in a business manner. They are required to cover all operating and expansion related costs while offering services at affordable and competitive prices. Cost containment is critical to maximizing profits targeted for reinvestment and provision of student services. Currently profit making ancillaries contribute \$1.2 million to student services and the funding of entrance scholarships. Sales grew by 3.2% to \$77.3 million in 2008/09.

Historical Perspective on Ancillary Sales Growth (\$'000's)



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

	\$ thousands		
SALES BY ANCILLARY OPERATIONS	2008/09	2007/08	% incr/(decr)
Bookstore	22,868	22,347	2.3%
Hospitality Services	18,545	18,424	.7%
Housing and Conference Services	19,766	19,322	2.3%
Printing	3,810	3,939	(3.3%)
Parking	3,936	3,809	3.3%
Continuing Education	4,012	2,626	52.8%
Telecommunications	2,700	2,684	.6%
Student Health Services	1,494	1,602	(6.7%)
Miscellaneous	157	147	6.8%
	77,288	74,900	3.2%
Less: internal sales	(11,686)	(10,492)	11.4%
	65,602	64,408	1.9%

Housing and Conference Services revenue benefited from the 2.4% increase in enrolment and high (99.9%) residence occupancy rates. A new contribution of \$75,000 was made from Conference Services profits in support of entrance scholarships. Hospitality revenues were impacted by meal plan refunds as a result of the Brandon Hall fire in October 2008.

Investment Income/Loss

A loss of \$14.8 million from investments is reflected in the Statement of Operations (2007/08 – income of \$23.1 million). Of that loss, \$28.3 million resulted from the investment loss on internal endowments, offset by net income earned in other funds of \$1.3 million, and \$12.2 million of previously earned investment income transferred from external endowments to match actual spending. The investment loss in the external endowment fund of \$66.7 million was charged directly to the fund and is not reflected in the Statement of Operations.

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 is set at a maximum of 4% of the three-year average December 31 market value of endowment capital. In 2008/09, approximately \$12.2 million (2007/08 – \$13 million) of expenses were funded from the external endowment, a significant proportion of which was directed towards student scholarships and bursaries and faculty compensation.

OTHER SOURCES OF REVENUE

Other sources of revenue include:

- \$94.7 million earned through various non-degree educational and other revenue-generating activities (2007/08 - \$81.0 million).
- \$28.8 million of restricted donations and other grants recognized in income based on expenses incurred in the year (2007/08 - \$37.7 million).
- \$37.2 million to recognize the amortization of capital assets funded through deferred capital contributions (2007/08 - \$41.0 million).

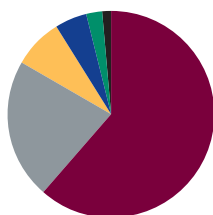
Key Financial Indicator 3

Strategic Deployment of Resources

Total expenses for 2008/09 increased by 5.0% to \$785.8 million. The breakdown by category of expense for each of the last two years is illustrated in the graphs below.

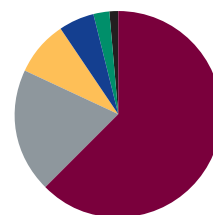
2008/09 Total Expenses
\$785.8 million

- Compensation 61.4%
- Supplies 22%
- Amortization 8%
- Student Aid 5%
- Cost of goods sold 2.3%
- Interest 1.3%



2007/08 Total Expenses
\$748.6 million

- Compensation 62.6%
- Supplies 19.6%
- Amortization 8.5%
- Student Aid 5.5%
- Cost of goods sold 2.4%
- Interest 1.4%



Compensation

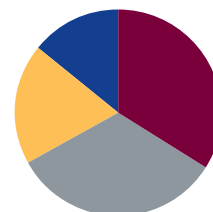
Total compensation expenses account for over 60% of total expenditures. A total of 6,702 permanent staff members were employed in October 2008 (October 2007 - 6,523).

Compensation expenses continue to increase faster than revenues. Total compensation expense of \$482.5 million represents 61.4% of total expenses. The decrease from 62.6% in 2007/08 is the result of:

- benefits comprising a lower portion of total compensation expenses
- \$7 million of one-time compensation costs in 2007/08 associated with the faculty retirement incentive program
- a significant increase in supplies and services

Faculty Members and Permanent Staff
As at October 2008 – 6,702

- Academic (includes PDFs, and Teaching Assistants) (2,286) 34%
- Administrative Support (2,217) 33%
- Academic (includes Faculty and Librarians) (1,289) 19%
- Research Support (910) 14%

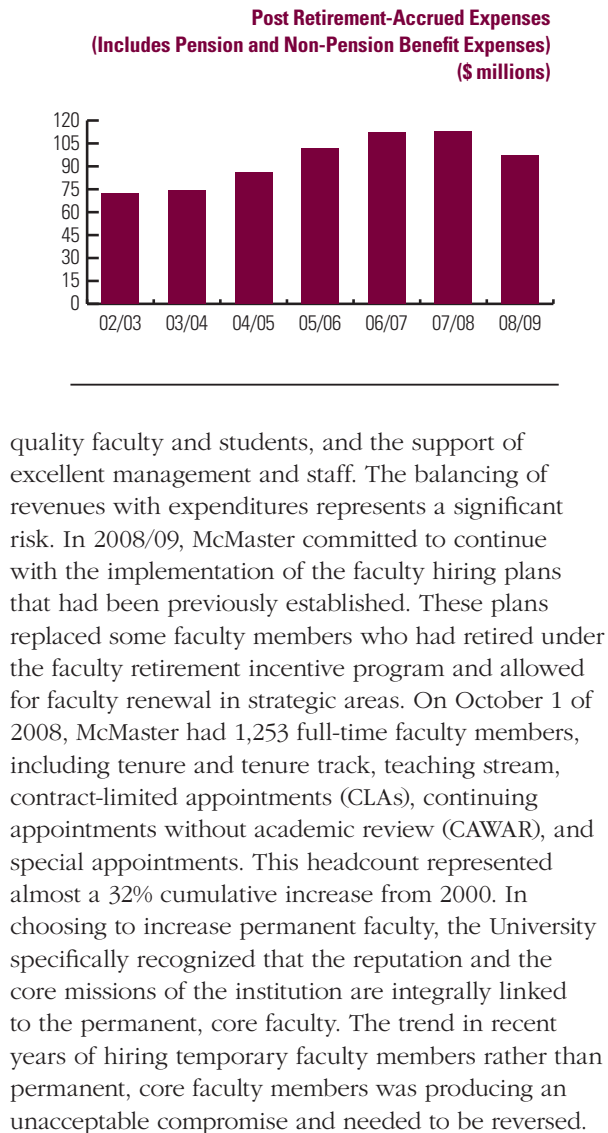


Employee benefits increased by 1.5% from 2007/08 and reduced as a percentage of salaries and wages from 30.9% to 30.3% due to the favourable impact of the increase in the discount rate used to calculate the future costs of pension and future non-pension benefit expenses. The second of three special pension deficit amortization payments of \$8.1 million is included in 2008/09 benefit expenses. While some positive steps have been taken to manage the rate of growth of pension benefits through changes in plan design, the effect of these strategies are dwarfed by the sizable pension funding shortfall resulting from investment losses in 2008/09. The costs required to compensate for this shortfall will continue to put significant pressure on operating and research budgets.

McMaster offers defined benefit plans that provide non-pension post-retirement benefits including extended health, dental and life insurance for substantially all of its full-time employees. Over the past few years, non-pension post-retirement benefits have not been available to new full-time non-union staff. The University continues to fund future non-pension benefits on a cash basis for employees who have this benefit and has budgeted \$5.6 million for 2009/10. The shortfall between the annual unfunded accrued cost of the benefits earned (\$20 million) and the cash cost of the benefits paid to retirees (2008/09 – \$4.6 million) is building an unfunded accrued benefit obligation for the University. The sheer size of this obligation in relation to McMaster's financial resources creates a significant risk to the University. Using its limited financial capacity to fund these growing obligations annually will put considerable pressure on other mission-critical expenditures and threatens its future competitive position.

Under the direction of the Finance Committee, the University Administration has been reviewing a plan which will provide for the level of employee benefits to become comparable with the level of such benefits at McMaster's comparator group of universities, over such reasonable time period as the Administration suggests, while maintaining the quality of the institution. The results of this review will impact the funding required for non-pension employee future benefits.

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. McMaster's continued success depends ultimately on the recruitment and retention of high-



Increasing core faculty must be supported financially through increases in revenue streams to Faculties or cuts in their expenses. Both approaches have been adopted by Faculty Deans – with reductions of temporary instructors as well as allocation of revenues from new programs toward support of faculty. Faculties have also reviewed major purchases and delayed them wherever possible. Despite the increases in the number of faculty and students, there has not been a corresponding increase in the number of administrative staff in academic areas. This has led to an increased workload as administrative departments have strained to offer excellent services to students and faculty.

In 2008/09, a review was undertaken to assess the distribution of undergraduate classes by size. Analysis showed that the percentage of undergraduate classes (excluding the Faculty of Health Sciences), with 40 or fewer students accounted for more than half of all of our classes (52%). For the undergraduate levels the proportion of classes with fewer than 30 students has increased from 2005/06 to 2008/09 by 39%, as reported in the CUDO reports. Classes under 30 students were 31% of the level 1 classes last year, 30% of level 2 classes, 39% of level 3 classes, and 83% of level 4 classes. While it is not clear that this dominance of small classes can be retained in these difficult budgetary times, the University has not implemented a blanket policy which eliminates courses with less than some minimum enrolment, choosing instead to examine the situation on a case-by-case basis. In 2008/09, faculties reviewed the classes offered to reduce the number of extremely low enrolment courses or sections and, in some cases, to offer courses in alternative years where that is possible. Class sizes are now limited and this may lead to some students not being able to register in their first choice of classes however, the University will ensure that students are able to register in courses required for their degree completion.

In recognition of the difficult financial situation, the senior leadership of McMaster voluntarily took actions regarding their compensation. The Senior Academic and Administrative Officers have frozen their salaries

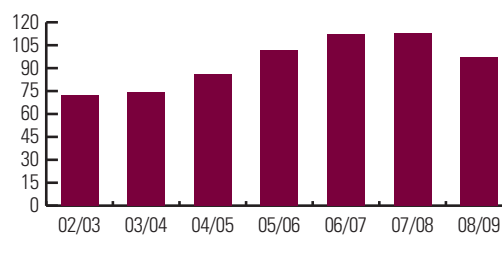
for a year, agreed to increases in pension contributions starting in January 2010 and, while grandfathering those currently in positions, closed their ranks to a defined benefit pension plan and to post-retirement benefits. In the future, those assuming such leadership roles will participate in a group RSP pension plan. Similarly the Deans and Associate Vice-Presidents have frozen their compensation for one year.

Student Financial Aid

Student aid (scholarships and bursaries) amounted to \$39.5 million (2007/08-\$40.9 million), a marginal decline from the previous year.

The amount of funding available to support the growing need for financial assistance declined as a result of investment losses cause by financial market volatility to \$97 million in endowments held for scholarships and bursaries (2007/08 - \$113 million).

**Funds Held for Scholarships and Bursaries
(\$ millions)**



The Province's 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 current economic environment has been particularly difficult for students and the University has noted an increased demand for bursary support. Meeting that increased need and recognizing that there is reduced funding available from endowments has created another source of pressure on the operating budget.

Capital Planning and Management

The 2002 McMaster Campus Plan provides a comprehensive framework to guide campus capital development. The plan is reviewed annually and was formally updated and re-issued in 2008. The plan ensures that the physical infrastructure is an appropriate reflection of McMaster's academic excellence. In the updated plan, the intimate qualities of the historic heart of the campus, with its collegiate-style buildings, formal open spaces and ravine setting, have been extended to the edges of the campus. A series of well designed new buildings, open spaces, and new compelling places that connect to each other and enhance the image and amenity of the University are included in the 2030 vision for the University.

This long term Campus Plan, along with a November 2008 Senate policy on Project Priorization will assist the University to prioritize projects against the available funds and borrowing capacity of the University. In 2008/09 no new external borrowing was undertaken. However the \$54 million deficiency of revenues over expenses has resulted in the University not meeting its internal debt management guideline for an *Interest Coverage* ratio of 3.0. The 2008/09 interest coverage ratio is (1.8) and the three-year average is 1.8. The investment losses, particularly the portion associated with the Internal Endowment, have had a similar impact on the *Expendable Resources to Debt* ratio. The year end ratio of 0.6 is below the benchmark guideline of 0.8. When calculated on a three year average the ratio is 1.1.

In 2008/09, several building projects consistent with the Campus Plan were underway. The chart below outlines the major new building and deferred maintenance projects along with the funding sources for each.

MAJOR BUILDING PROJECTS			
PROJECT	BUDGET	FUNDING SOURCES	EXPECTED COMPLETION
Fit out of 2nd Floor of MDCL	\$18.5 million	Donors, University	2009
New Engineering Building	\$48 million	MTCU & research grants, Donors, University	2009
Deferred maintenance projects	\$13.5 million	MTCU June 08 Campus Renewal Grant	2009

Projects for new buildings with long term funding sources such as student levies, user fees, parking levies, and future fundraising are currently being financed through internal loans. Net internal loans have grown from \$49.1 million as of April 30, 2008 to \$68.9 million at April 30, 2009. The loans have various repayment terms. The back log of deferred maintenance currently stands at \$140 million (07/08 – \$125 million). In relation to replacement value, deferred maintenance has declined slightly to 8.5% (2007/08 – 9%).

Investment in Capital Assets

McMaster's capital expenditures for 2008/09 of \$101.7 million (2007/08 - \$94.8 million) are summarized in the tables below.

CAPITAL ASSET ADDITIONS	2008/09 (\$ thousands)
Completed building projects and construction in progress	\$ 61,042
Computers, furnishings and other equipment	35,525
Library materials	5,125
	\$ 101,692
FUNDING SOURCE FOR ADDITIONS	
Deferred capital contributions	\$ 51,990
Internally funded (includes internal loans)	49,702
	\$ 101,692

Strategic Deployment of Resources – Strategic Initiatives

■ Ron Joyce Centre at the DeGroote School of Business – in Burlington

Construction on the new Centre is currently underway on the South Service Road, west of Appleby Line in Burlington. The Centre will house McMaster's MBA programs and a range of new executive education initiatives for business people from the western Golden Horseshoe area. In addition to the new campus building, the expansion plan also includes establishing a regional family medicine centre and resident program, and a future affiliation with Joseph Brant Memorial Hospital. The City of Burlington and the Region of Halton have each pledged \$5 million for the project. Mr. Ron Joyce has pledged \$10 million to the project, and the land on which the new centre will be constructed will be donated by Michael H. DeGroote of Westbury International.

■ McMaster Innovation Park (MIP) – in Hamilton on Longwood Road

In pursuit of its *Refining Directions* goal to achieve

the next level of research, McMaster University purchased the former Camco site in west Hamilton for \$13 million to develop the McMaster Innovation Park (2005). The 37-acre (14.8 hectares) site will be vital to the growth and support of the research and development arm of a number of key research areas, including advanced manufacturing and materials, biotechnology and nanotechnology. At the mid point of calendar 2009, MIP is poised to complete two significant goals:

1. Complete the development lease-up of a multi-tenant multi-purpose laboratory and office facility to act as a catalyst and focal point for initial park development. This is an \$18 million renovation of the existing red brick building on the site. The University is providing interim financing and has agreed to provide a debt service deficiency undertaking on the external long-term debt that MIP will put in place to finance this renovation.
2. In line with the objective to attract high-profile laboratories and research facilities that function as a magnet for the creation of a materials and manufacturing facility, MIP has initiated the construction of the CANMET MTL building during 2009. The CANMET MTL lab relocation from Ottawa is expected to be complete by 2010. The \$69.2 million project will be financed \$12 million from the tenant and \$57.2 million of 25 year non-recourse financing. MIP will retain ownership of the building.

Strategic Deployment of Resources – Looking Forward

In recent years, a number of committees and task forces have been established to focus the implementation of the *Refining Directions* strategic plan. The newly created President's Advisory Committee on the Impact of the Current Economic Situation (PACICES) has been meeting since early 2009 to gain a better understanding of the impact of the economic downturn and prepare recommendations to address the current short-term financial challenges while positioning the University to pursue opportunities to advance the long-term vision. Its interim report was released in October 2009.

Key Financial Indicator 4

Strong Financial Position and Management of Business Risks

On balance, the financial position of the University weakened in 2008/09:

FINANCIAL POSITION STRENGTHS

- net assets invested in capital assets increased by \$25.2 million from \$194.3 million at April 30, 2008 to \$219.5 million at April 30, 2009
- departmental carry-forwards of \$67.4 million increased by \$8.0 million signaling positive in year results for many departments
- long-term debt per FTE student declined from \$6,600 to \$6,401

FINANCIAL POSITION CHALLENGES

- total assets amounted to \$1.72 billion compared to \$1.74 billion at April 30, 2008, a decline of 1.5%
- current liabilities and long term obligations of \$545.2 million increased by \$44.2 million over 2007/08, primarily due to the increases in accounts payable and accrued employee future benefits
- operating net assets, which include unrestricted, employee future benefits and specific purpose reserves declined by \$48.0 million. The increase of \$22.4 million in the employee future benefits deficiency resulted from the required pension and non pension employee future benefit liability increases
- net internal loans for capital projects increased to \$68.9 million (2007/08 - \$49.1 million)
- internal endowment declined from \$133.2 million in 2007/08 to \$98.8 million in 2008/09
- total endowment per FTE student decreased from \$20,800 to \$17,300

Internal and External Endowments

Endowments are comprised of externally restricted donations as well other funds that have been internally restricted by the Board of Governors. Investment income on permanent external endowments is recorded in the Statement of Operations when this income is made available for spending in accordance with the University's preservation of capital policy. This policy was established in 2005 with the objective of protecting the real value of the endowments and providing a stable funding source for expenditures. The policy limits the amount of net income for spending from individual trust funds to 4% of the average previous 3 year market value (as at December 31 annually). As a result, \$12.2 million was made available for spending in the 2008/09 fiscal year. Because the net investment income was negative, the spending amount was funded by the accumulated reinvested income from prior years. For endowments without sufficient accumulated investment income, temporary encroachment on capital was permitted. The encroached amounts will be recovered from future investment returns. In 2008/09 there was an investment loss of \$66.7 million allocated to the externally restricted endowments. In accordance with the preservation of capital policy, this loss and the amount made available for spending of \$12.2 million were deducted from endowment net assets. After recording endowed donations and transfers of \$25.1 million, the market value of the University's permanent external endowment decreased by \$54.7 million year over year. Total external trust funds declined to \$318.3 million (2007/08 – \$356.9 million) which is \$12.3 million below the original capital.

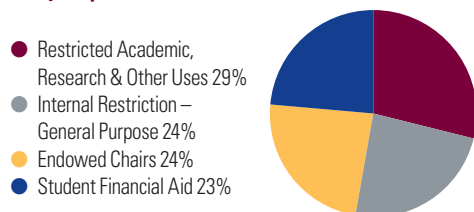
Internal Endowments declined to \$98.8 million (2007/08 – \$133.2 million) primarily as a result of the investment loss in the year of \$28.3 million. This loss, along with the annual allocation of \$5.5 million to the operating fund and net changes of \$0.6 million, resulted in a total reduction of \$34.4 million in Internal Endowments.

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, 2009, of (20.0%) (2007/08 – (1.1%)), which was slightly better than the policy benchmark (a loss of 21.0%). Under the direction of the Investment Committee, the University regularly reviews its asset mix and monitors the performance of its investment managers. For the fiscal year ending April 30, 2009 the loss, after expenses was (18.9%) (2007/08 – (0.1%)). The absolute size of the negative return will impact the future ability of the University to continue to maintain the approximately

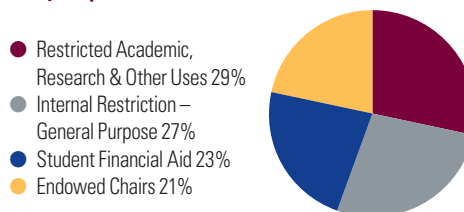
\$17 million in allocations for spending from the Internal and External Endowments which support strategic areas of expenditures, such as scholarships, research and bursaries. As a result, in March 2009 the Finance Committee of the Board approved a one year ‘override’ to the General Expenditure Policy restricting spending in 2009/10 from any external endowment fund that had a market value below its original donated capital as of December 31, 2008. In addition, the Finance Committee will be reviewing the expected long-term rate of return and the allocation for spending in the 2009/10 fiscal year to ensure that the endowments continue to grow and provide long-term support to future activities of the University.

Funds for student scholarship and bursaries represent 23% of total endowments. Funds held to support faculty salaries and research activities through the endowed chairs program represent 24%. Restricted Academic Research and other uses represent 29% of the total endowments held.

Endowment Funds at April 30, 2009
By Purpose \$417.1 million



Endowment Funds at April 30, 2008
By Purpose \$490.1 million



“ Our goal is to provide an innovative and stimulating learning environment where students can prepare themselves to excel in life. ”

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 registered and non-registered pension plans, measured at April 30, 2009, is a deficit of \$373 million (2007/08 – deficit of \$158.1 million).

The change in the funded status of the defined benefit pension plans from April 30, 2008 to April 30, 2009 is summarized as follows:

CHANGE IN FUNDED STATUS OF PENSION BENEFIT PLANS		(\$ millions)
Funded status, April 30, 2008		(158.1)
Costs in the period:		
Current service cost		(33.1)
Interest on liabilities		(77.2)
Actual loss on plan assets		(185.6)
		(295.9)
Actuarial gain related to changes in discount rate	42.0	
Actuarial loss related to new valuation and salary assumptions	(4.9)	
University contributions	43.9	
Funded status, April 30, 2009		(373.0)

Investment losses, along with the current service cost and interest on liabilities generated a net increase in the deficit position. This increase was somewhat mitigated by the impact of a change in the discount rate to 7.5% from 6.25% (\$42 million). This discount rate increase 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 2008/09 of \$45.6 million was increased from the expense for 2007/08 (\$41.9 million) and includes amortization of actuarial losses of \$11.9 million (2007/08 - \$15.4 million).

The University submitted its funding valuation for the pension plans as of July 1, 2008 and is required to submit the next funding valuations as of July 1, 2011. Based on the results of the July 1, 2008 valuation,

the University will continue with the plan to fund minimum deficit payments of \$8.4 million for 2009/10 from a combination of an increase in the charge (2.1 to 2.4 times employee contributions) to the operating and research budgets, along with contributions from reserves and the internally restricted endowment. Current service costs will continue to be fully funded through the charge to operating and research budgets for 2009/10.

Other – Post retirement and Post Employment Benefit Plans

The deficit status of the non-pension post retirement benefit plan as at April 30, 2009 amounted to \$195.0 million, a decrease of \$8.1 million from April 30, 2008. The significant changes are outlined in the chart below:

CHANGE IN FUNDED STATUS OF NON-PENSION BENEFIT PLANS		(\$ millions)
Funded status, April 30, 2008		(203.1)
Costs in the period:		
Current service cost		(9.0)
Interest on liabilities		(12.7)
		(21.7)
Actuarial gain related to change in assumptions for discount rate	41.9	
Change in trend assumption for health costs	(12.8)	
Other	(3.9)	
University contributions	4.6	
Funded status, April 30, 2009		(195.0)

A full actuarial valuation was completed in May 2007 and extrapolated until April 30, 2009. The discount rate is based on high quality corporate bond yields as at April 30, 2009, resulting in an increase in the rate of 1.25%, which in turn accounts for the decrease in the liability.

Non-pension employee future benefit expense in 2008/09 of \$24.2 million decreased by \$3.0 million from 2007/08. The decrease reflects the impact of the lower discount rate.

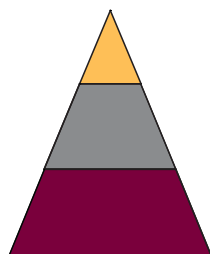
The University continues to fund future non-pension benefits on a cash basis and has budgeted \$5.6 million in 2009/10. This amount is consistent with estimates provided by the actuaries. Under the 2008 direction of the Finance Committee of the Board of Governors, the University is currently reviewing its plan to manage non-pension employee future benefits. For 2009/10 a small benefit surcharge will be used to begin to generate a sinking fund to offset a portion of the future costs of these benefits.

Management of Risk and the Control Environment

An essential component of the University's 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 with input from 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 EWRM program is scheduled for review and confirmation by Management, Risk Owners and the Audit Committee of the Board in the fall of 2009 as to the program's elements and its future activity.

The *Internal Audit Plan* considers the linkages among enterprise risks, business processes, protection of assets and business activities in an effort to direct the monitoring and audit efforts according to the significance of the risk. Ranking is determined in each area according to the risk events' potential impact/materiality 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:

- Under the leadership of the newly appointed Chief Information Officer (CIO) update the University Technology Strategy to address technology risk.
- Internal Audit Department reviews of various departments and faculties which provide assurance and consulting services through a comprehensive risk based audit and process review plan.
- Internal Audit Department has established a *Continuous Audit and Monitoring Process* which results in the review and verification of various transactions and activities in near real time.
- On going communication with its External Auditors and other regulatory auditors.
- Monitoring of legal and other claims.
- The establishment of a Fraudulent Activity and Whistle Blower policy including the installation of a dedicated web portal for reporting such activity in confidence through the portal's hot line.



Summary

Reviewing the financial results against the four financial goals illustrates the significant challenges facing the University.

1. *Strong demand for programs*: continued and the University slightly exceeded its enrolment targets for Undergraduate students.
2. *Increasing and diversifying the revenues*: challenged in 2008/09 by the severe financial market losses and its impact on investment income.
3. *Strategic deployment of resources*: challenged by the growth in employment and other costs while revenue declined and by the need to balance short term operational needs with the long term financial health of the University.
4. *Maintenance of the strong financial position and management of business risks*: challenged by the significant financial loss sustained by the endowments, the reduction in operating net assets due to the decline in reserves, and by the turbulence in the economic environment.

Management of the University will not lose sight of the long-term vision and our commitment to manage its financial challenges. Management will continue to focus attention on revenue generation, control of rising benefit costs, long term investment management and strategic deployment of resources to support the mission and vision of the institution.

“ Our vision is to achieve international distinction
for creativity, innovation and excellence. ”

Supplemental Information on the 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: General 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 operating fund budget does not include the accrued costs of post-retirement benefits and the special payments to fund the salaried pension plan deficit.

The 2008/09 operating budget reflected the second year of the three year plan to:

- eliminate the in-year, ongoing operating deficit within 3 to 5 years, recognizing that the above noted expenses are excluded;
- allow the University to make strategic faculty and staff appointments;
- make the changes that enable McMaster to move forward;
- focus on its strategic assets; and
- use appropriations to finance one time expenditures.

Considerable attention and effort focused significant resources on addressing the deficit and the University finished the year with a 1.8% surplus in the operating fund.

	2008/09 OPERATING FUND (\$ millions)				
	Budget	Projection	Actual	Variance	
				Budget vs. Actual	Projection vs. Actual
Sources of revenue	\$ 419.2	\$ 443.5	\$ 452.8	\$ 33.6	\$ 9.3
Less: expenditures	437.1	451.3	444.7	(7.6)	6.6
Add: amount funded by (transferred to) unrestricted net assets	—	(0.5)	(0.1)	(0.1)	0.4
Excess (deficiency) of revenue over expenditures	(17.9)	(8.3)	8.0	25.9	16.3
Fund balance, beginning of year*	59.4	59.4	59.4	—	—
Fund balance, end of year	\$ 41.5	\$ 51.1	\$ 67.4	\$ 25.9	\$ 16.3

*adjusted to actual

Total operating fund revenues were \$452.8 million as compared to the projected funding of \$443.5 million. The favourable variance of \$9.3 million (2.1%) is primarily due to increased research overhead income (\$5.0 million), and greater than expected investment income earned on working capital balances (\$3.3 million).

Total operating fund expenditures were \$444.7 million as compared to projected expenditures of \$451.3 million. The favourable variance of \$6.6 million (1.5%) is due to a reduction in salary and wage expense. Non-salary expenses tracked to projection, with unfavourable variances in utilities and supplies offset by favourable variances in equipment, scholarships, professional development expenses and library acquisitions.

As a result, budget appropriations transferred to internally restricted net assets increased by \$8.0 million, which is \$16.3 million more than projected. One-time funding included in appropriations will be allocated for expenditure in 2009/10, with the remaining appropriations expected to provide funds to offset one-time spending and investments in deficit-reducing strategies.



McMASTER UNIVERSITY
ANNUAL FINANCIAL REPORT
2008/09

**FINANCIAL STATEMENTS –
APRIL 30, 2009**

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Statement of Management Responsibility

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.

Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles developed by The Canadian Institute of Chartered Accountants. Management believes the financial statements present fairly the University's financial position as at April 30, 2009 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, 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 (Canada) Limited 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 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 management.

The financial statements for the year ended April 30, 2009 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.

A handwritten signature in black ink, appearing to read "P. George".

Dr. P. George
President and Vice-Chancellor
July 31, 2009

A handwritten signature in black ink, appearing to read "Karen Belaire".

Ms. K. Belaire
Vice-President, Administration
July 31, 2009



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, 2009 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, 2009 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, stylized font and is underlined with a single horizontal stroke.

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
July 31, 2009

McMASTER UNIVERSITY

Statement of Financial Position

April 30, 2009, with comparative figures for 2008

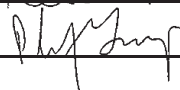
(thousands of dollars)

	2009	2008
		(note 19)
Assets		
Current assets:		
Cash and equivalents	\$ 76,182	\$ 112,571
Government grants and other accounts receivable	62,920	44,640
Research grants receivable	69,486	80,729
Inventories	5,642	4,414
Prepaid expenses	5,001	4,995
Loan receivable (note 2)	15,963	-
	235,194	247,349
Investments (note 3)	563,211	614,020
Investment in McMaster Innovation Park (note 2)	13,318	13,318
Capital assets (note 4)	683,777	644,744
Deferred pension asset (note 5)	220,811	222,282
	\$ 1,716,311	\$ 1,741,713
Liabilities, Deferred Contributions and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 116,730	\$ 95,862
Deferred revenue	36,772	34,466
Current portion of long-term obligations (note 6)	1,060	997
	154,562	131,325
Accrued employee future benefits (note 5)	224,891	205,058
Long-term obligations (note 6)	165,775	164,402
Deferred contributions (note 7):		
Deferred for future expenses	282,679	255,551
Deferred capital contributions	314,333	299,489
	597,012	555,040
Net assets:		
Operating:		
Unrestricted	(146)	1,807
Internally restricted (note 8)	9,794	55,790
Equity in capital assets (note 9)	219,452	194,265
Endowments (note 10):		
Internal	98,832	133,166
External	246,139	300,860
	574,071	685,888
Commitments and contingencies (note 11)		
	\$ 1,716,311	\$ 1,741,713

On behalf of the Board of Governors:



Chair, Board of Governors



President and Vice-Chancellor

McMASTER UNIVERSITY

Statement of Operations

Year ended April 30, 2009, with comparative figures for 2008

(thousands of dollars)

	2009	2008
Revenues:		
Operating grants	\$ 208,673	\$ 199,915
Research grants and contracts	154,733	140,613
Tuition fees	141,323	132,723
Ancillary sales and services	65,602	64,408
Other (note 12)	94,682	80,968
Investment (loss) income, net	(14,739)	23,112
Donations and other grants	28,799	37,695
Research overhead grants	15,600	14,553
Amortization of deferred capital contributions	37,146	41,047
	731,819	735,034
Expenses:		
Salaries and wages	370,227	357,644
Employee benefits	112,264	110,638
Supplies and services	230,588	206,297
Interest on long-term debt	10,034	10,128
Amortization of capital assets	62,659	63,846
	785,772	748,553
Deficiency of revenues over expenses	\$ (53,953)	\$ (13,519)

McMASTER UNIVERSITY

Statement of Changes in Net Assets

Year ended April 30, 2009, with comparative figures for 2008

(thousands of dollars)

	Operating			Equity in capital assets	Endowments		2009 Total	2008 Total
	Unrestricted	Employee future benefits	Specific purposes		Internal	External		
								(note 19)
Net assets, beginning of year:	\$ 1,807	(13,771)	69,561	194,265	133,166	300,860	685,888	703,193
Deficiency of revenues over expenses	(28,440)	-	-	(25,513)	-	-	(53,953)	(13,519)
External endowment contributions:								
Contributions	-	-	-	-	-	24,132	24,132	13,937
Protection of capital	-	-	-	-	-	(79,853)	(79,853)	(17,241)
Transfers and adjustments:								
Transfers for specific purposes	45,996	(22,417)	(23,579)	-	-	-	-	-
Capital transactions from operating (note 9)	(50,700)	-	-	50,700	-	-	-	-
Transfer from internal endowments	33,334	-	-	-	(33,334)	-	-	-
Transfer to external endowments	-	-	-	-	(1,000)	1,000	-	-
Net change in unrealized losses on interest rate swap agreements (note 6)	(2,143)	-	-	-	-	-	(2,143)	(482)
	(1,953)	(22,417)	(23,579)	25,187	(34,334)	(54,721)	(111,817)	(17,305)
Net assets, end of year	\$ (146)	(36,188)	45,982	219,452	98,832	246,139	574,071	685,888

McMASTER UNIVERSITY

Statement of Cash Flows

Year ended April 30, 2009, with comparative figures for 2008

(thousands of dollars)

	2009	2008
Cash flows from operating activities:		
Deficiency of revenues over expenses	\$ (53,953)	\$ (13,519)
Adjustments for non-cash items:		
Amortization of deferred capital contributions	(37,146)	(41,047)
Amortization of capital assets	62,659	63,846
Increase in accrued employee future benefits	19,833	22,407
Increase in decommissioning obligation	291	276
Change in deferred pension asset	1,471	690
	(6,845)	32,653
Net change in contributions deferred for future expenses	27,128	57,921
Loan receivable	(15,963)	-
Net change in non-cash working capital	14,903	17,790
	19,223	108,364
Cash flows from financing and investing activities:		
Purchase of capital assets	(101,692)	(94,778)
Net change in investments	50,809	(25,622)
Net change in external endowments	(55,721)	(3,304)
Deferred capital contributions	51,990	40,740
Principal repayments on long-term obligations	(998)	(936)
	(55,612)	(83,900)
Net increase (decrease) in cash	(36,389)	24,464
Cash and equivalents, beginning of year	112,571	88,107
Cash and equivalents, end of year	\$ 76,182	\$ 112,571

McMaster University (the "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 2). 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.

(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 (l)) 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) Financial instruments:

Recognition and Measurement:

Financial instruments are initially recorded on the statement of financial position at fair value. They are subsequently valued at fair value or amortized cost depending on the classification selected for the financial instrument. Financial assets are classified as either "held-for-trading", "held-to-maturity", "available-for-sale" or "loans and receivables" and financial liabilities are classified as either "held-for-trading" or "other liabilities". Financial assets and liabilities classified as held-for-trading are measured at fair value with changes in fair value recorded in the statement of operations. Financial assets classified as held-to-maturity or loans and receivables and financial liabilities classified as other liabilities are subsequently measured at amortized cost using the effective interest method.

The University has classified its financial instruments as follows:

- Cash and cash equivalents and all investments other than the strip bonds held for the Hedden residence sinking fund are classified as held-for-trading.
- The strip bonds in investments held for the Hedden residence sinking fund are classified as held-to-maturity.
- Government grants and other accounts receivable and research grants receivable are classified as loans and receivables.
- Accounts payable and accrued liabilities, and current and long-term obligations are classified as other liabilities.

The University has elected to expense transaction costs related to financial instruments classified as other than held-for-trading. The University has elected to use trade date accounting for regular-way purchases and sales of financial assets. The University has elected not to separately account for embedded derivatives.

Hedges:

Derivative instruments are recorded on the statement of financial position at fair value, with changes in fair value of derivative instruments recognized in the statement of operations, with the exception of derivatives that the University has designated as an effective cash flow hedge.

The University's interest rate swap agreements have been designated as effective and are measured at fair value at the year end date and included on the statement of financial position. The effective portion of the gain or loss is recorded as a direct increase or decrease in net assets, and the ineffective portion, if any, is recognized in the statement of operations.

Disclosure and Presentation:

In 2006, the Canadian Institute of Chartered Accountants ("CICA") had made certain pronouncements concerning new disclosure and presentation standards for financial instruments, and which were to be effective for the fiscal year 2009. During the year, the CICA eliminated these requirements for not-for-profit entities and accordingly, the University has continued to employ the existing standards for its 2009 financial statements.

1. Significant accounting policies (continued):**(d) 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.

(e) Inventories:

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

(f) 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%

(g) 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 \$49,000 (2008 - \$261,000) and are charged to operations in the year of acquisition.

(h) 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.

(i) 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):

(j) Employee future benefits:

The University maintains separate defined benefit registered plans providing pension benefits for most of 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.

The University also makes regular contributions to its Group Registered Retirement Savings Plan ("RRSP"), administered by a third party, on behalf of each eligible employee. Group RRSP contributions are charged to operations in the year made.

(k) 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):

(l) 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 earned (interest, dividends, realized and unrealized capital gains, net of expenses).

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.

(m) 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.

(n) 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.

(o) Foreign currency translation:

The University accounts for transactions in foreign currencies at the exchange rates in effect at the time of the transactions. At year end, monetary assets and liabilities in foreign currencies are translated at year end exchange rates. Foreign exchange gains and losses on investments have been included in investment returns.

(p) 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.

(q) Future accounting policy changes:

The CICA has issued revisions to the 4400 series and certain other Handbook sections to amend or improve sections relating to not-for-profit organizations. With respect to presentation, these changes include making the disclosure of net assets invested in capital assets optional; making CICA 1540 "Cash Flow Statements" applicable to not-for-profit organizations; and requiring the reporting of revenues and expenses on a gross basis in the statement of operations unless not required by other guidance. A new Section, CICA 4470 "Disclosure of Allocated Expenses by Not-for-Profit Organizations", was included in the revisions which require certain disclosures when fundraising and general support expenses are allocated to other functions. These changes in accounting policies will be adopted for the year ending April 30, 2010. Management is currently assessing the impact of these revisions.

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

2. McMaster Innovation Park:

Details of the investment in McMaster Innovation Park are as follows:

(thousands of dollars)	2009	2008
Balance, beginning of year	\$ 13,318	\$ 13,318
Share in net earnings	-	-
Balance, end of year	\$ 13,318	\$ 13,318

The First Longwood Innovation Trust and The Gore District Land Trust ("Park") 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.

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

(thousands of dollars)	December 31 2008	December 31 2007
Total assets	\$ 44,831	\$ 27,748
Total liabilities	\$ 15,558	\$ 1,143
Total deferred revenue and capital grants	15,955	13,287
Total trusts' equity	13,318	13,318
	\$ 44,831	\$ 27,748
Results of operations:		
Total revenue	\$ 1,321	\$ 1,306
Total expenses	1,321	1,306
Net earnings for the year	\$ -	\$ -
Cash flows:		
Cash flows from operating activities	\$ (485)	\$ 562
Cash flows from financing and investing activities	(1,815)	(2,201)
Decrease in cash	\$ (2,300)	\$ (1,639)

The University has established a non-revolving loan facility which bears interest at prime less 0.25% and is due on demand or December 31, 2009, whichever occurs earlier. At April 30, 2009, outstanding draws and accrued interest amounted to \$15,963,350. In June 2009, the University provided the Park with a non-revolving operating loan facility of up to \$3 million under which the University will provide cash advances bearing interest at prime plus 3%.

Included in accounts receivable at April 30, 2009 is an amount of \$49,128 (2008 - \$111,419) receivable from the Park.

In addition to the information disclosed elsewhere, the University had the following related party transactions with the Park for their year ended December 31, 2008:

- provided payroll services at a fee (1% of total salaries paid) which amounted to \$3,519;
- paid rent in the amount of \$99,964 (2007 - \$72,000).

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

2. McMaster Innovation Park (continued):

The Park has entered into an agreement with Natural Resources Canada to design, build, finance and lease a new CANMET Materials Technology Laboratory at a total cost of \$69.2 million to be financed \$12 million from the tenant and \$57.2 million of 25 year mortgage financing. Under this agreement, McMaster University has agreed to support the obligation of the Park to fund 50% of any construction cost overruns in excess of the 10% contingency included in the project budget.

3. Investments:

Details of investments are as follows:

(thousands of dollars)	2009		2008	
	Fair Value	Cost	Fair Value	Cost
Equities:				
Canadian	\$ 93,007	\$ 100,454	\$ 134,459	\$ 101,840
United States	76,181	92,050	94,810	103,047
Non-North American	70,122	99,045	106,482	108,621
	239,310	291,549	335,751	313,508
Fixed income	\$ 314,677	\$ 311,121	\$ 272,443	\$ 267,965
Other	9,224	9,676	5,826	5,335
	\$ 563,211	\$ 612,346	\$ 614,020	\$ 586,808

Investments are exposed to foreign currency risk, interest rate risk, and market volatility. The University manages these risks through policies and procedures in place governing asset mix, equity and fixed income allocations, and diversification among and within categories.

4. Capital assets:

(thousands of dollars)	Cost	Accumulated amortization	2009 Net
Land	\$ 3,494	\$ -	\$ 3,494
Buildings	722,228	237,354	484,874
Decommissioning retirement costs	213	34	179
Site improvements	13,276	5,643	7,633
Library materials	123,828	92,774	31,054
Equipment, furnishings and vehicles	321,426	256,542	64,884
Computing systems and computing equipment	112,204	89,597	22,607
Construction in progress	69,052	-	69,052
	\$ 1,365,721	\$ 681,944	\$ 683,777

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

4. Capital assets (continued):

(thousands of dollars)	Cost	Accumulated amortization	2008 Net
Land	\$ 3,494	\$ -	\$ 3,494
Buildings	634,437	219,863	414,574
Decommissioning retirement costs	213	26	187
Site improvements	6,412	5,367	1,045
Library materials	120,308	87,947	32,361
Equipment, furnishings and vehicles	298,855	235,468	63,387
Computing systems and computing equipment	110,074	83,044	27,030
Construction in progress	102,666	-	102,666
	\$ 1,276,459	\$ 631,715	\$ 644,744

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)	2009		
	Pension		Other
	Registered	Supplemental	
Accrued benefit obligation	\$ 1,171,592	\$ 75,511	\$ 194,946
Fair value of plan assets	874,080	-	-
Funded status - deficiency	(297,512)	(75,511)	(194,946)
Reconciliation to deferred benefits (accrued future benefits):			
Unamortized past service cost	(3,212)	2,121	-
Unamortized actuarial loss	521,535	12,019	31,426
Deferred pension asset (accrued employee future benefits)	\$ 220,811	\$ (61,371)	\$ (163,520)

(thousands of dollars)	2008		
	Pension		Other
	Registered	Supplemental	
Accrued benefit obligation	\$ 1,149,749	\$ 67,653	\$ 203,126
Fair value of plan assets	1,059,331	-	-
Funded status - deficiency	(90,418)	(67,653)	(203,126)
Reconciliation to deferred benefits (accrued future benefits):			
Unamortized past service cost	(3,472)	2,474	-
Unamortized actuarial loss	316,172	4,007	59,240
Deferred pension asset (accrued employee future benefits)	\$ 222,282	\$ (61,172)	\$ (143,886)

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

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

5. Employee future benefits (continued):

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

(thousands of dollars)	2009		2008	
	Pension	Other	Pension	Other
Net benefit expense	\$ 45,588	\$ 24,223	\$ 41,940	\$ 27,186

(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	59%	65%	8.3%
Debt securities	40%	35%	4.6%
Other	1%	0%	3.0%

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

	Pension	Other
Discount rate	7.50%	7.50%
Expected long-term rate of return on plan assets	7.00%	-
Rate of compensation increase	5.25%	4.50%

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

	Pension	Other
Discount rate	6.25%	6.25%
Expected long-term rate of return on plan assets	7.00%	-
Rate of compensation increase	5.25%	4.50%

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

(thousands of dollars)	2009		2008	
	Pension	Other	Pension	Other
Employer contributions	\$ 43,917	\$ 4,588	\$ 41,562	\$ 4,470
Employee contributions	14,022	-	12,698	-
Benefits paid	57,638	4,588	56,043	4,470

(g) For measurement purposes, an 8.6% annual rate of increase in per capita medical cost was assumed for 2007, grading down to 4.5% per annum in and after 2027. For per capita dental costs, an annual rate of increase of 4% per annum was assumed.

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

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, 2007; the next required filing date is July, 2010.
- salaried employees pensions (Plan 2000): completed as at July, 2008; the next required filing date is July, 2011.
- other benefit: completed as at April 30, 2007.

The results of each valuation have been extrapolated to April 30, 2009, which is the measurement date used to determine the accrued benefit obligation for all employee future benefit plans.

(i) In 2008 the University created a group RRSP for certain types of new employees. University and employees' contributions in 2009 amounted to \$11,000 each.

6. Long-term obligations:

Details of long-term obligations are as follows:

(thousands of dollars)	Maturity	Interest Rate	Current portion	Non-current portion	2009 Total Outstanding	2008 Total Outstanding
Residence mortgage (a)	May 2011	9.81%	\$ -	\$ 11,544	\$ 11,544	\$ 11,544
Bank loan (b)	Dec 2012	floating	607	1,815	2,422	2,992
Mortgage	Oct 2016	5.38%	101	810	911	1,009
Bank term loan (c)	May 2033	floating	352	19,102	19,454	19,784
Debentures (d)	Oct 2052	6.15%	-	120,000	120,000	120,000
			1,060	153,271	154,331	155,329
Decommissioning obligation (e)			-	5,994	5,994	5,703
Interest rate swap agreements (f)			-	6,510	6,510	4,367
			\$ 1,060	\$ 165,775	\$ 166,835	\$ 165,399

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

2010	\$ 1,060
2011	1,128
2012	12,744
2013	1,028
2014	580

(a) A sinking fund 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 \$5,149,000 (2008 - \$4,766,000).

(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%.

6. Long-term obligations (continued):

- (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%.
- (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 voluntary sinking fund 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 \$8,205,000 (2008 - \$10,432,000).

- (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, 2009, the fair value of the trust funds amounted to \$4,798,000 (2008 - \$6,593,000). In total, the net present value of the estimated cost for decommissioning, at April 30, 2009 is \$5,994,000 (2008 - \$5,703,000) using a risk free rate of 5.1%.

- (f) The University has in place two interest rate swap agreements. The first agreement is for 10 years and expires in 2012, while the second agreement is for 30 years and expires in 2033. Under the terms of the first agreement, the University agrees with the counterparty to exchange, at specified intervals and for a specified period, its floating interest on the loan (note 6(b)) for a fixed rate of 6.25%. Under the terms of the second agreement, the University agrees to receive a floating interest rate on the loan (note 6(c)) while paying a fixed rate of 6.384%. The use of the agreements effectively enables the University to convert the floating rate interest obligations of the loans into fixed rate obligations and thus manage its exposure to interest rate risk.

The notional and fair values of the interest rate swap agreements are as follows:

(thousands of dollars)	2009		2008	
	Notional Value	Fair Value	Notional Value	Fair Value
10-year interest rate swap	\$ 2,423	\$ (235)	\$ 2,992	\$ (182)
30-year interest rate swap	19,454	(6,275)	19,784	(4,185)
	\$ 21,877	\$ (6,510)	\$ 22,776	\$ (4,367)

The change in fair value of the swaps for the year ended April 30, 2009 are as follows:

- 10-year: (\$53,000) (2008 - \$(24,000))
- 30-year: (\$2,090,000) (2008 - (\$458,000))

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

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)	2009	2008
Balance, beginning of year, as restated (note 19)	\$ 255,551	\$ 197,630
Deferred and capital contributions received	279,887	287,819
	535,438	485,449
Less:		
Amounts recognized as revenue	(200,769)	(189,158)
Deferred capital contributions transfer	(51,990)	(40,740)
Balance, end of year	\$ 282,679	\$ 255,551

Deferred contributions consist of the following:

(thousands of dollars)	2009	2008
Research grants and contracts	\$ 159,095	\$ 159,868
Donations, other grants and investment income	72,125	56,037
Capital grants and donations	46,830	36,750
Other restricted funds	4,629	2,896
	\$ 282,679	\$ 255,551

(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)	2009	2008
Balance, beginning of year	\$ 299,489	\$ 299,796
Add: contribution transfers	51,990	40,740
Less: amount amortized to revenue	(37,146)	(41,047)
Balance, end of year	\$ 314,333	\$ 299,489

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

8. Internally restricted net assets:

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

(thousands of dollars)	2009	2008
Employee future benefit related:		
Pensions	\$ 120,090	\$ 120,876
Other retirement and post employment benefit plans	(156,278)	(134,647)
	(36,188)	(13,771)
Specific purposes:		
Unexpended departmental carryforwards	67,381	59,439
Other	34,123	44,014
	101,504	103,453
Sinking funds	13,370	15,214
Capital projects	(68,892)	(49,106)
	45,982	69,561
	\$ 9,794	\$ 55,790

Included in unexpended departmental carryforwards is a \$5,000,000 (2008 - \$5,500,000) advance to the Faculty of Science from unrestricted net assets for which arrangements for recovery are in place.

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

		2009
Project	Funding Source	Balance (thousands of dollars)
Engineering Building	Graduate funding, pledges, fundraising	\$ (14,293)
Les Prince Residence	Ancillary operations	(19,289)
David Braley Athletic Centre	Student levies, pledges, fundraising	(15,684)
Stadium and Parking Project	Parking fees, pledges, fundraising	(29,407)
Residence Wiring Project	Ancillary operations	(560)
McMaster Biosciences Incubation Centre	Rental and other income	(1,008)
Michael DeGroote Centre for Learning, 2nd Floor	Graduate funding, pledges, fundraising	(4,393)
Other projects (net)	Various	15,742
		\$ (68,892)
		2008
Project	Funding Source	Balance (thousands of dollars)
Les Prince Residence	Ancillary operations	\$ (19,728)
David Braley Athletic Centre	Student levies, pledges, fundraising	(17,385)
Stadium and Parking Project	Parking fees, pledges, fundraising	(26,800)
Residence Wiring Project	Ancillary operations	(1,081)
McMaster Biosciences Incubation Centre	Rental and other income	(1,107)
Other projects (net)	Various	16,995
		\$ (49,106)

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

9. Equity in capital assets:

The equity in capital assets is calculated as follows:

(thousands of dollars)	2009	2008
Capital assets	\$ 683,777	\$ 644,744
Less amounts financed by:		
Net long-term debt	(149,992)	(150,990)
Unamortized deferred capital contributions	(314,333)	(299,489)
	\$ 219,452	\$ 194,265

Details of the transfer for capital transactions are as follows:

(thousands of dollars)	2009	2008
Repayment of long-term debt	\$ 998	\$ 936
Capital asset purchases from operating	49,702	54,022
	\$ 50,700	\$ 54,958

10. Endowments:

(a) Internal:

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

(thousands of dollars)	2009	2008
Balance, beginning of year	\$ 133,166	\$ 154,823
Donations	86	518
Investment income (loss)	(28,292)	(1,726)
Net transfers and expenses	(5,128)	(20,449)
Transfer to external endowments	(1,000)	-
Balance, end of year	\$ 98,832	\$ 133,166

Included in internal endowments is an amount of \$46,509,148 (2008 - \$62,506,704) 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.

10. Endowments (continued):

(b) External:

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

(thousands of dollars)	2009	2008
Balance, beginning of year, as restated (note 19)	\$ 300,860	\$ 304,164
External contributions:		
OTSS	3,627	4,392
Other	20,505	9,545
Income retained (withdrawn) - capital protection policy	(79,853)	(17,241)
Transfer from internal endowments	1,000	-
Balance, end of year	\$ 246,139	\$ 300,860

In 2009 there was an investment loss of \$66,700,000 (2008 - \$4,100,000) on external endowments. In accordance with the endowment capital protection policy, this loss and the amount made available for spending of \$12,200,000 (2008 - \$13,100,000), were deducted from endowment net assets. The amount made available for spending of \$12,200,000 was recorded as investment income in the statement of operations.

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") on behalf of certain retired and active Clinical Faculty members who were, or are, members of 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 \$70,395,000 at April 30, 2009 (2008 - \$78,960,000).

11. Commitments and contingencies (continued):

(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)

2010	\$	2,783
2011		2,303
2012		1,398
2013		1,257
2014		806

12. Other income:

Details of other income are as follows:

(thousands of dollars)	Major Sources	2009	2008
Faculty of Health Sciences	Government specifically funded programs	\$ 38,925	\$ 37,689
Other Faculties	Non-degree educational fees, international postgraduate stipends, space/equipment rentals, other student fees	26,857	21,595
Academic Services	Nuclear reactor sales, contracts and patent royalties, registrar administration fees	11,374	9,425
Student Services	Athletics and Recreation memberships and user fees	11,297	9,436
Miscellaneous	Application fees, late payment fees	6,229	2,823
		\$ 94,682	\$ 80,968

13. Related party transactions:

In addition to transactions and balances disclosed in note 2, the University had the following transactions with:

- Fundraising entities: funds received during the year amounted to \$915,000 (2008 - \$13,103,000).
- Joint venture: the University's share of income amounted to \$230,000 (2008 - \$332,000).

14. Capital management:

In managing capital, the University focuses on liquid resources available for operations. The University's objective is to have sufficient liquid resources to continue operating even if adverse financial events were to occur and to provide it with the flexibility to take advantage of opportunities that will advance its mission. The need for sufficient liquid resources is considered in the preparation of its annual and capital budgets and by monitoring and forecasting of cash flows. The University maintains a line of credit of \$15 million which can be used in the event of a short term deficiency in cash flow. The line of credit was not used in 2009. In addition, the University can issue unsecured debentures or enter into other long-term debt to assist in the financing of capital projects.

15. 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, 2009 and 2008 in the first phase of the Ontario Student Opportunity Trust Fund (OSOTF I) balance:

(thousands of dollars)	2009	2008
Endowment balance, beginning of year	\$ 33,077	\$ 32,144
Investment income (used from) retained for protection of capital	(3,965)	1,044
Investment income transferred from (to) expendable income	294	(111)
Endowment balance, end of year	29,406	33,077
Funds available for awards, beginning of year	-	-
Investment income	1,254	1,191
Bursaries awarded (2009 - 905 awards; 2008 - 1,150 awards)	(960)	(1,302)
Investment income transferred (to) from endowment balance	(294)	111
Funds available for awards, end of year	-	-
Total funds at book value	\$ 29,406	\$ 33,077

The market value of the endowment as at April 30, 2009 was \$24,828,000 (2008 - \$33,962,000).

(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 years ended April 30th:

(thousands of dollars)	2009	2008
Endowment balance, beginning of year	\$ 6,097	\$ 5,967
Investment income (used from) retained for protection of capital	(629)	130
Endowment balance, end of year	5,468	6,097
Funds available for awards, beginning of year	22	18
Investment income for expenditures	205	184
Bursaries awarded (2009 - 209 awards; 2008 - 190 awards)	(197)	(180)
Funds available for awards, end of year	30	22
Total funds at book value	\$ 5,498	\$ 6,119

The market value of the endowment as at April 30, 2009 was \$4,738,000 (2008 - \$5,928,000).

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Notes to Financial Statements

Year ended April 30, 2009

16. Ontario trust for student support:

External endowments include grants for funding student aid provided by the Government of Ontario's Ontario Trust for Student Support (OTSS) matching program. Under the program, the Province will provide an equivalent matching contribution for external endowment contributions made to a specified ceiling. Pursuant to the program requirements, separate disclosures are required as at March 31st.

The following is the schedule of changes in the endowment balance and expendable funds for the years ended March 31, 2009 and 2008:

(thousands of dollars)	2009		2008	
Endowment balance, beginning of year	\$	17,040	\$	12,488
Cash donations received		1,670		2,252
Funds received/receivable from MTCU		2,007		2,312
Investment income retained for (used from) protection of capital		1,259		(12)
Endowment balance, end of year		21,976		17,040
Funds available for awards, beginning of year		630		319
Investment income for expenditures		656		514
Bursaries awarded (2009 - 221 awards; 2008 - 177 awards)		(536)		(203)
Funds available for awards, end of year		750		630
Total funds at book value	\$	22,726	\$	17,670

The market value of the endowment as at March 31, 2009 was \$18,070,000.

17. Pledges receivable:

Outstanding but unrecorded pledges for donations and other fund raising amounted to \$77,299,466 (2008 - \$58,908,369).

18. Fair value of financial instruments:

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

(thousands of dollars)	2009		2008	
	Book Value	Fair Value	Book Value	Fair Value
Long term debt:				
- with fixed interest rates	\$ 132,455	\$ 135,995	\$ 132,553	\$ 154,271
- with variable interest rates (without consideration of interest rate swaps)	21,876	21,876	22,776	22,776

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(f).

McMASTER UNIVERSITY

Notes to Financial Statements

Year ended April 30, 2009

19. Change in reporting endowments:

In fiscal 2007, the University reviewed its interpretation for the calculation for the retention of investment income in connection with its Endowment Capital Protection Policy. During the year, the University determined that the cumulative market adjustment of \$13,744 on externally restricted endowment funds at April 30, 2007 was not reclassified between deferred contributions for future expenses and external endowments. The adjustment has been recorded retrospectively as follows:

(thousands of dollars)	Increase (Decrease)
Statement of Financial Position:	
Deferred contributions for future expenses	\$ (13,744)
External endowments	\$ 13,744

20. Comparative figures:

Certain comparative figures for 2008 have been reclassified to conform with the financial presentation adopted in the current year.



1280 Main Street West
Hamilton, Ontario
L8S 4L8