Annual Financial Report 2009/2010

McMaster University

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Photo: Atrium of Burlington Ron Joyce Centre

Atrium: Ron Joyce Centre, McMaster Burlington Campus

Year in Review

The year 2009/10 was challenging. The rebound in the world financial markets and additional funding from the province, while welcome and significant contributors to the University's in-year surplus position of $11.7 million, were not sufficient to restore McMaster to financial health. Although improved from 2008/09, total net assets remain 6% below 2007/08 and the component of net assets which is available for general University purposes (Available Expendable Resources)[1] of $170 million is down by 17% from 2007/08 levels. Reduced financial flexibility impacts the University's ability to fund core operations and extraordinary expenses and to take advantage of strategic future opportunities.

HIGHLIGHTS AT A GLANCE	2009/2010	2008/2009	2007/2008
Total Net Assets ($ millions)	629.3	574.1	685.9
Available Expendable Resources ($ millions)	170	145	205
Capital Spending ($ millions)	93.9	101.7	94.8
Endowment per FTE student ($)	18,400	17,300	20,800
Total Revenue per FTE student ($)	33,100	30,400	31,200
Total Revenue ($ millions)	828.4	731.8	735
Total Expenditures ($ millions)	816.7	785.8	748.6
Excess (Deficiency) of Revenues over Expenses ($ millions)	11.7	(53.9)	(13.5)
Excess of Revenues over Expenses Operating Fund only ($ millions)	3.7	8	9.9
Long Term Investment Pool Return (%)	17.1%	-18.9%	-0.1%
Employee Future Benefit Unfunded Obligation – Registered Pension ($ millions)	(296.1)	(297.5)	(90.4)
Employee Future Benfit Unfunded Obligation – Non Pension ($ millions)	(214.6)	(194.9)	(203.1)
Enrolment (Full Time Equivalent (FTE))[2]	25,007	24,104	23,501

1 Available Expendable Resources (AER) represents funds the University holds that do not have an externally committed purpose such as unrestricted net assets, specific purpose reserves and appropriations and internally restricted endowments.

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

Despite the strong investment performance in the year, the registered pension plan deficits did not improve and our obligation remains at almost $300 million which is significantly higher than the $90 million deficit recorded in 2007/08. The province has recently announced some welcome relief measures that will assist the University to smooth out its pension deficit payments over time but this will not eliminate the need to either make significant special payments to the plan, or make material changes to the plan design. This remains the biggest financial risk to the University. In March 2010, this factor along with other financial challenges noted throughout this report resulted in the University's AA bond rating falling to AA (low).

Although $94 million was invested in capital assets this year, the University strains to identify funding sources for capital projects. The Ron Joyce Centre for Advanced Management Studies has been completed with significant donations and grants from the City of Burlington and Halton Region. This campus, located in Burlington, will house over 400 MBA students starting this fall. Although the Nuclear Research Building Renovation and the Centre for Spinal Cord Education, Research, and Rehabilitation were both 100% funded through the federal and provincial Knowledge Infrastructure Programs, other capital projects were funded through internal capital loans. Net internal central bank capital loans have grown from $68.9 million as of April 30, 2009 to $74.0 million at April 30, 2010, and will continue to grow further. Required deferred maintenance expenditures and demand for additional space and equipment will be an ongoing challenge in future years.

The McMaster Innovation Park (MIP) continues to develop as a key entity for McMaster and the City of Hamilton. During the year MIP undertook additional debt to support critical infrastructure improvements needed to establish the park as a strategic research and commercialization enterprise. The University agreed to cover debt service payments on up to $23 million of debt in the event that McMaster Innovation Park is unable to make its payments.

In addition to the improvements in investment income and provincial funding noted above, the University achieved its undergraduate, graduate and medical education enrolment growth targets and received full funding for these programs. Total revenue increased at a pace greater than expenditures for the first time in several years and revenue per FTE student increased by 9% over 2008/09. Year over year expenditure growth of 3.9% declined from previous annual growth rates, demonstrating the positive effect of the concerted efforts by management, faculty and staff to identify and implement cost reduction strategies.

The President's Advisory Committee on the Impact of the Current Economic Situation (PACICES) was formed in 2009 and was charged with the responsibility of developing strategic advice to the President to ensure the long term sustainability of the University. Their report, which was received in February 2010, will guide the University as it focuses attention on revenue generation, control of total compensation costs and strategic deployment of resources to address its financial risks and improve its financial health. Critical financial risks include sourcing funding for pension and non pension obligations, and the large deferred maintenance backlog. Consistent with the PACICES report, the University will enhance active dialogue, both as McMaster and as a member of associations, with the Province of Ontario and the Federal Government on the pressures facing universities and the steps necessary to ensure that McMaster can deliver on its core missions of teaching and research.

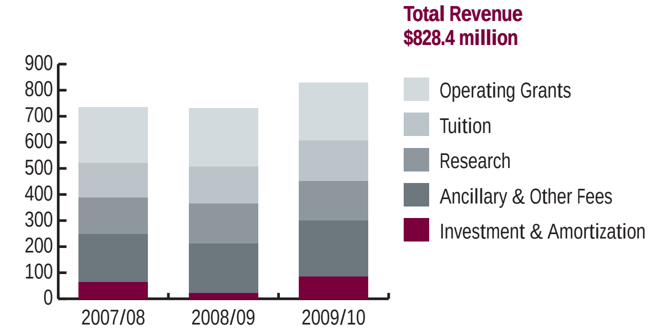
The information contained in this Annual Financial Report is intended to provide the reader with financial information for the fiscal year ended April 30, 2010 and was approved for publication by the Board of Governors in October 2010. While the focus of this document will be the consolidated operations of all funds on an accrual basis, information on the Operating Fund, which accounts for almost 60% of expenditures, is also included.

Other documents that the reader can reference to provide a more in-depth discussion of the University are as follows:

- 2010-11 Consolidated Budget – June 2010
- State of the Academy – September 2010
- McMaster Fact Book – November 2009

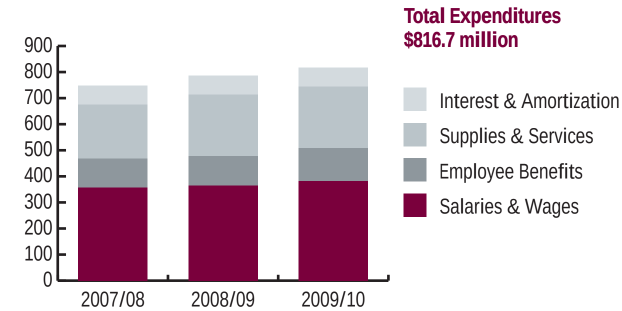
Financial Analysis: Highlights

Total Revenue



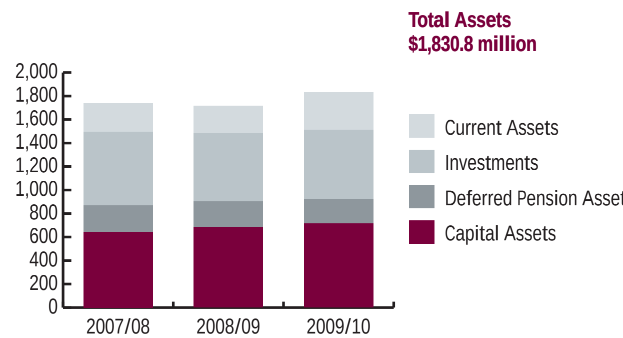
- Revenues increased in 2009/10 from $731.8 million to $828.4 million mainly as a result of positive investment income
- Increases in all other categories, except research grants and contracts, resulted in an overall increase of 13.2%
- Although research receipts increased by 6.3%, the amount of research funding recognized as grant and contracts decreased by 2.6%

Total Expenses



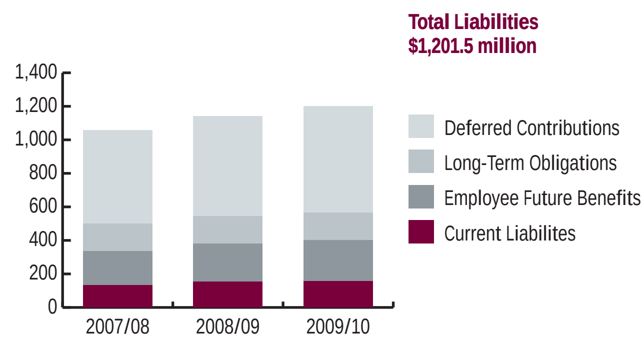
- On an overall basis expenditures grew by 3.9%
- Salaries and wages increased by 4.6%
- Employee benefits grew by 12% mainly due to accruals and special payments required for pension and non-pension future benefit plans

Total Assets



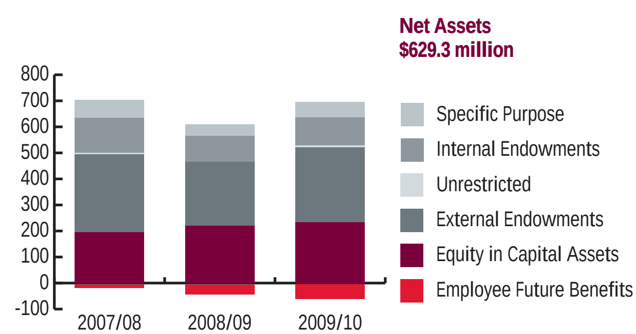
- Assets grew by 6.7%, primarily due to an improvement in the return on investments
- The sharp increase in cash ($94.3 million) is as a result of a reduction in the allocation to the short term bond fund, and a corresponding increase to money market funds (classified as cash and equivalents)

Total Liabilities



- Liabilities grew 5.2% due to the growth in employee future benefits and in deferred contributions
- Employee future benefits grew by 9.1% reflecting mainly the decrease in the long term discount rate associated with the obligation

Net Assets

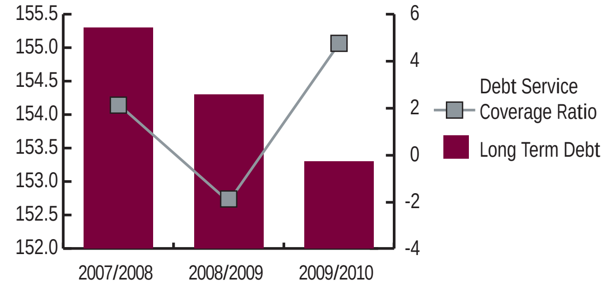


- Net assets grew by 9.6% mainly as a result of the increase in the external endowment (16.9%), offset by the increase in the deficiency resulting from employee future benefits
- External endowment grew as a result of new endowed donations of $8.6 million and investment income of $22.1 million

Long Term Debt Ratios

- In 2009/10 external long term debt decreased by $1 million
- Debt service coverage ratio improved due to a positive net income and lower debt
- Required capital borrowing was completed using internal loans ($74 million in 2009/2010 vs. $68.9 million in 2008/09)

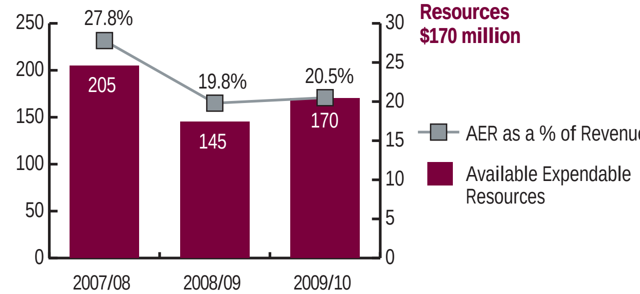
Long Term Debt
$153.3 million



Available Expendable Resources (AER)

- AER represents funds that the University holds that do not have an externally committed purpose, such as unrestricted net assets, specific purpose reserves and internal endowments
- AER increased marginally to 20.5% of revenue

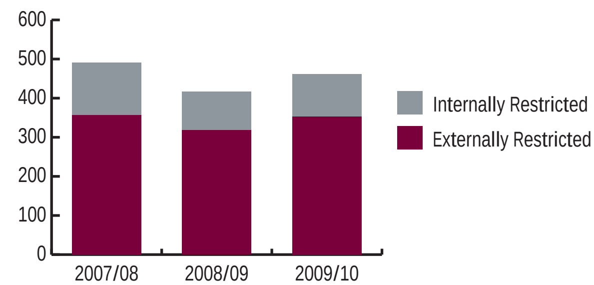
Available Expendable Resources
$170 million



Endowment Funds

- McMaster's internal and external endowments including the expendable portions grew by 10.9%
- Total endowment per student increased from $17,304 to $18,425 year over year
- As of December 31, 2009, McMaster had the 7th largest endowment in Canada

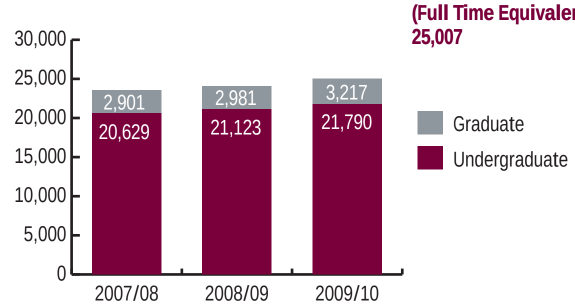
Trusts and Endowments
$460.7 million



Enrolment (Full Time Equivalent (FTE))

- McMaster experienced a 3.7% increase in FTE enrolment year over year (25,007 vs. 24,104)
- Revenue per FTE increased from $30,400 to $33,100
- FTE enrolment is calculated as the number of full time students plus (part time enrolment/3.5)

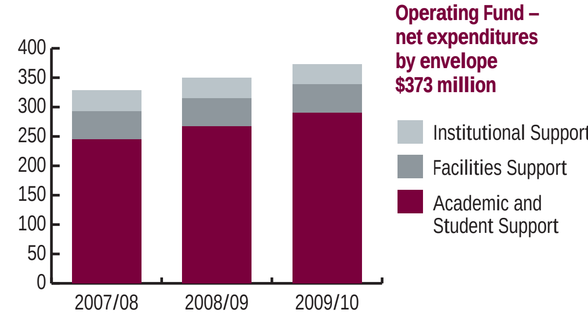
Enrolment
(Full Time Equivalent)
25,007



Operating Fund – net expenditures by envelope

- Operating fund expenditures increased by 6.6%
- Academic and student support areas increased by 8.6%, while institutional support areas declined by 2.9%
- Increase in academic spending is consistent with university's budget decision to allocate resources strategically in support of the academic mission

Operating Fund –
net expenditures
by envelope
$373 million



Wall feature, atrium: Ron Joyce Centre
McMaster Burlington Campus

Revenues

In 2009/10 total revenue increased by 13.2%. Translated into revenue per FTE enrolment of $33,100, this is higher than the 2008/09 equivalent at $30,400, primarily as a result of investment income.

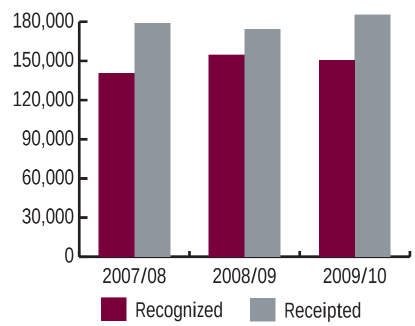
Operating Grants Income

Government operating grants of $222.9 million increased by $14.2 million or 6.8% over 2008/09 grants of $208.7 million. Increases to MTCU funding continue to be tied to specific performance outcomes such as increasing enrolment. Undergraduate accessibility and graduate expansion funding is received based on each University's share of year over year growth, and represents $7.3 million (51%) of the increase over 2008/09. This amount included an increase to the per-unit funding rate and full incremental funding for all students. Expanded MD and Post Graduate medical education funding was provided to increase the number of physicians in the province. This funding increased by $5.9 million and represented 42% of the overall grant increase. Additional one-time Quality grants totaling $2.5 million were also received.

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, $185.3 million (2008/09 - $174.2 million) was received for future use. After deferrals, research revenue recognized over the past year has decreased by 2.7% to $150.5 million (2008/09 - $154.7 million).

Research Revenue: Receipted vs Recognized in Income - $ thousands



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. As illustrated in the table research receipts grew by $11.1 million on a year over year basis.

	$ millions	
RESEARCH REVENUE RECOGNIZED	**2010**	**2009**
Federal Government	111.8	100.2
Province of Ontario	24.6	16.6
Other sources	48.9	57.4
Total research funds received	185.3	174.2
Less: amount deferred to future	(34.8)	(19.5)
	150.5	**154.7**

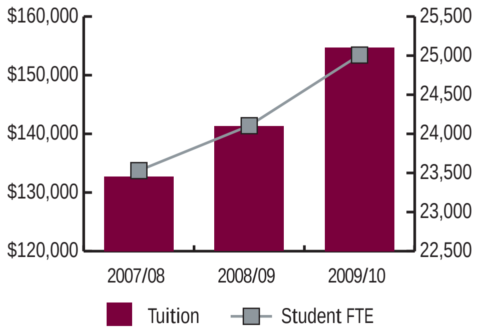
Research Overhead Grants

Research overhead grants assist the University in funding the indirect costs of research. In 2009/10, $14.2 million was received (2008/09 - $15.6 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 9.5% in 2009/10 as a result of a 3.7% 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 permitted the University to increase tuition fees for regulated programs by an overall maximum of 5% per year. In 2009/10, the University increased fees by the maximum allowable increase for each regulated program and remained within the overall cap of 5%. The average tuition per student FTE increased by slightly more than 5% as a result of the rate increase and also as a result of more graduate students (with higher fees) than undergraduate students. The number of international students, where fees are higher than those of domestic students, increased by 1.8%. International students now account for approximately 6.4% of the total population.

Tuition – Total $ thousands and Number of FTE Students[3]



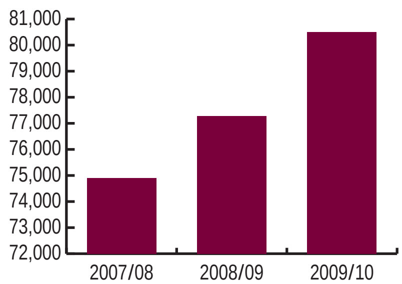
3 FTE enrolment is calculated as the number of full time students plus (part time enrolment/3.5)

Atrium and lounge: Ron Joyce Centre, McMaster Burlington Campus

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. Sales, including internal sales, grew by 4.2% to $80.5 million in 2009/10.

Historical Perspective – Ancillary Sales Growth
$ thousands



A detailed breakdown of Ancillary revenues follows:

	$ thousands	
SALES BY ANCILLARY OPERATIONS	**2009/10**	**2008/09**
Bookstore	22,459	22,868
Hospitality Services	19,610	18,545
Housing and Conference Services	21,008	19,766
Printing	3,680	3,810
Parking	4,887	3,936
Continuing Education	4,212	4,012
Telecommunications	2,794	2,700
Student Health Services	1,680	1,494
Miscellaneous	180	157
	80,510	77,288
Less: internal sales	(11,754)	(11,686)
	68,756	**65,602**

Parking revenues increased by 24% due to the full implementation of the automated parking system in all of the main lots on campus. Housing and Conference Services revenue benefited from the 3.7% increase in enrolment and high residence occupancy rates. In 2009/10, hospitality revenues benefited from an increase in conference business and cash sales.

Investment Income

The capital market recovery in 2009/10 followed on the heels of two negative years. A 17.1% fiscal year rate of return (after expenses) mitigated a significant portion of the losses from the prior two years when the loss on the long term investment pool totaled 18.9% in 2008/09 and 0.1% in 2007/08. 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, 2010, of 22.2% (2008/09 - (20%)) which was slightly lower than the benchmark return of 24.4%. Total investment income, which includes earnings from the short term investments as well as the long term investment pool, is allocated between direct contributions to external endowments and income in the statement of operations as summarized in the table below.

	$ thousands	
INVESTMENT INCOME/(LOSS)	**2009/10**	**2008/09**
Recognized in income	48,748	(14,739)
Posted directly to External Endowments	33,603	(79,853)
	82,351	**(94,592)**

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 2009/10, approximately $9.7 million (2008/09 - $12.2 million) of expenses were funded from the external endowment, a significant proportion of which was directed towards student scholarships and bursaries and funding of chairs and professorships.

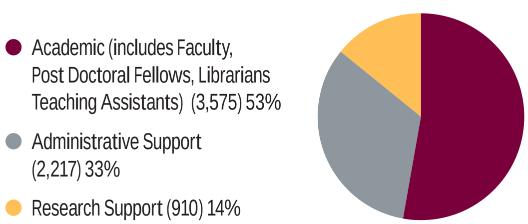
Compensation and Benefits

Salaries and wage expenses are reflected in the Statement of Operations. Employee benefit costs incurred in the fiscal year are identified as a separate line. The employee benefit expenses include accruals for pension and other post retirement benefits (primarily medical benefits and dental care), earned for current service. The long term obligations, determined on an actuarial basis, continue to grow. In accordance with generally accepted accounting policies, a portion of the obligation is recognized in the Statement of Financial Position and the balance (unfunded deficit) is reflected in the Notes to the Financial Statements. Additional detail on the current year's expense, the liability and the unfunded future obligations for pension and non pension future benefits is included in this section.

Expense

Total compensation expenses account for over 60% of total expenditures. A total of 6,781 permanent staff members were employed in October 2009 (October 2008 - 6,702).

Faculty Members and Permanent Staff As at October 2009 – 6,781

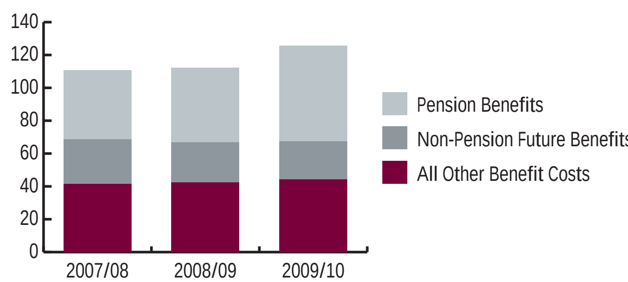


The total number of faculty members and permanent staff increased by 1.2%, and total salaries and wage expense increased by 4.5%. Compensation expenses account for a larger portion of total expenditures than in 2008/09. Total compensation expense of $507.7 million represents 62.2% of total expenses. The increase from 60.7% in 2008/09 is mainly the result of a 12% year over year increase in employee benefit costs, driven mainly by pension costs.

McMaster offers defined benefit plans that provide pension and non-pension retirement benefits including extended health, dental and life insurance for substantially all of its full-time employees. The annual increase in benefit expense for pension, which is exacerbated by the need to amortize the deficit in the plan and non-pension employee future benefit costs has been significant. The size of this obligation in relation to McMaster's financial resources creates a significant risk to the University.

As illustrated in the graph below, these two costs have increased by over $12 million or 20% since 2007/08. Using its limited financial capacity to fund these growing obligations annually has put considerable pressure on the University's ability to fund other mission-critical expenditures.

Employee Benefit Expense $125.6 million



The sharp increase in pension expense from 2008/09 is primarily due to the unfavourable impact of the decrease in the discount rate used to calculate pension benefit expenses and the negative investment returns in the pension plan. The second of three annual special pension deficit amortization payments of $9.9 million is included in 2009/10 benefit expenses ($8.1 million in 2008/09).

Employee Future Benefit Obligations (Pension and Other)

As noted in the previous paragraphs, the University records the benefits plans' asset and liability values and the related expenses as determined actuarially and in accordance with generally accepted accounting principles. As a result, actuarial and investment gains or losses are taken into income over many years.

Pension

While several positive steps have been taken to manage the rate of growth of pension benefits such as changes in plan design, revised eligibility rules for some groups of new employees, introduction of group RRSP for other new employees and increased employee contributions for others, the effect of these strategies are dwarfed by the sizable pension funding shortfalls especially in the salary pension plan. The costs required to compensate for this shortfall will continue to put significant pressure on operating and research budgets for many years to come.

The funded status of the total of the defined benefit hourly and salary pension plans for each of the last two years is summarized as follows:

CHANGE IN FUNDED STATUS OF PENSION BENEFIT PLANS

	APRIL 30, 2010 $ millions	APRIL 30, 2009 $ millions
Funded status, opening balance	(373.0)	(158.1)
Costs in the period:		
Current service cost	(27.6)	(33.1)
Interest on liabilities	(94.7)	(77.2)
Actual gain (loss) plan assets	154.5	(185.6)
	32.2	(295.9)
Actuarial (loss) gain related to changes in discount rate	(96.9)	42.0
Actuarial gain (loss) related to new valuation and salary assumptions	15.0	(4.9)
Plus: University contributions	47.3	43.9
Funded status, closing balance	**(375.4)**	**(373.0)**

Better than expected investment returns of 18.2%, offset by the current service cost and interest on liabilities, generated a net reduction of $32.2 million in the deficit position in 2009/10. This decrease was totally offset by the impact of a change in the discount rate to 6% from 7.5% ($96.9 million). This discount rate increase had a sizable negative impact on the funded position due to the long (17 year) duration of the liabilities. Despite the strong investment performance in 2009/10, the deficit remains at $375 million. There was no change for the expected long-term rate of return on plan assets at 7%.

The pension expense for 2009/10 of $58.4 million increased from 2008/09 ($45.6 million) and includes amortization of actuarial losses of $14.4 million (2008/09 - $11.9 million).

The University submitted its funding valuation for the salaried pension plan (over 96% of the assets) as of July 1, 2008 and is required to submit the next funding valuation 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 for 2010/2011 from an increase in the charge to the Operating and Research Budgets, along with increased employee contributions.

The University is required to file a valuation for its salaried pension plan on July 1, 2011 and expects that significant increases in deficit payments will be required. Recent changes to the Ontario Pension Benefits Act may delay and/or reduce the magnitude of the payments over the next several years; however, it is not reasonable for the size of the deficit to be eliminated without future contributions or further changes in plan design.

Other - Post Retirement and Post Employment Benefit Plans

The deficit status of the non-pension post retirement benefit plan as at April 30, 2010 amounted to $214.6 million, an increase of $19.6 million from April 30, 2009. The significant changes in each of the last two years are outlined in the following chart.

CHANGE IN FUNDED STATUS OF NON-PENSION BENEFIT PLANS

	APRIL 30, 2010 $ millions	APRIL 30, 2009 $ millions
Funded status, opening balance	(195.0)	(203.1)
Costs in the period:		
Current service cost	(7.8)	(9.0)
Interest on liabilities	(14.4)	(12.7)
	(22.2)	(21.7)
Actuarial (loss) gain related to changes in discount rate	(41.8)	41.9
Gain due to updated utilization data	47.2	0.0
Loss due to change in trend assumption for health costs	(7.1)	(12.8)
Other	(0.7)	(3.9)
University contributions	5.0	4.6
Funded status, closing balance	**(214.6)**	**(195.0)**

The University's three year valuation was completed in May 2010. This work included an analysis of actual claim costs and refinements to the claim cost methodology and to the Ontario Drug Benefit Plan offsets. The significant gains resulting from these changes ($47.2 million) were almost completely offset by the change in the discount rate ($41.8 million). The discount rate is based on high quality corporate bond yields as at April 30, which decreased by 1.5% year over year. Non-pension future employee benefit expense in 2009/10 of $23.0 million decreased by $1.2 million from 2008/09.

Artist's rendering: Atrium, McMaster Innovation Park

Artist's rendering: McMaster Innovation Park, Longwood Rd., Hamilton

Capital Projects and Financing

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.

Capital Projects

In 2009/10 several building projects were underway. The chart below outlines the major new building projects along with the funding sources for each.

MAJOR BUILDING PROJECTS – as of April 30, 2010

PROJECT	BUDGET	FUNDING SOURCES	EXPECTED COMPLETION
KIP – Nuclear Research Building Renovations	$22 million	Federal and Provincial Governments	2011
KIP – Centre for Spinal Cord Education, Research and Rehabilitation	$20 million	Federal and Provincial Governments and Donors	2011
Ron Joyce Centre for Advanced Management Studies – Burlington	$26.8 million	City and Region Grants, Donors and University	2010

KIP (Knowledge Infrastructure Program) projects were undertaken as part of a two-year $2 billion government economic stimulus measure to support infrastructure enhancement at postsecondary institutions across Canada. In 2009/10, McMaster received approval for two projects (listed above) that were critical to the University's ability to support its current students and researchers and to develop the infrastructure needed to capture the value created from innovation. These projects are on track for completion in March 2011.

The Ron Joyce Centre for Advanced Management Studies (CAMS) project was completed in September 2010. The nine-acre site is located on the South Service Road of the Queen Elizabeth Highway near Appleby Line in Burlington and will house the Faculty of Business Masters and Executive Education programs.

The University's total capital expenditures for 2009/10 of $93.9 million (2008/09 - $101.7 million) is summarized in the adjacent table.

	$ thousands
CAPITAL ASSET ADDITIONS	**2009/10**
Completed Building Projects and Construction in Process	56,079
Computers, Furnishings and Other Equipment	32,681
Library Materials	5,098
	93,858

The backlog of Deferred Maintenance currently stands at $119 million (2008/09 - $140 million). In relation to replacement value, Deferred Maintenance has stayed fairly consistent with a Facilities Condition Index of 8.7% (2008/09 – 8.5%).

Capital Financing

The long term Campus Plan, along with the December 2007 Debt Policy, and the November 2008 Senate policy on Project Priorization have guided the University to prioritize projects against the available funds and borrowing capacity. Projects for new buildings with long term funding sources such as student levies, user fees, parking levies, and future fundraising have been financed through internal central bank loans. Net internal central bank capital loans have grown from $68.9 million as of April 30, 2009 to $74 million at April 30, 2010. The loans have varying repayment terms and interest rates which reflect the date of issue and the project income stream. In 2009/10 no new external borrowing was undertaken.

There are two financial statement ratios included in the Debt Policy. These ratios measure University balance sheet resources and annual cash flow. They provide guidelines to ensure the University's capacity and affordability for additional debt. In addition, they assist the University in maintaining financial equilibrium.

The chart below outlines these ratios as well as an additional ratio recommended by the President's Advisory Committee on the Impact of the Economic Situation (PACICES). Available Expendable Resources (AER) as a % of revenues provides a measure of operating flexibility.

RATIO	GOAL	GUIDELINE	2007/08	2008/09	2009/10	3-YR AVG.
Expendable resources to debt	Capacity	Greater than 0.8	1.2	0.7	0.7	1.1
Interest coverage ratio	Affordability	Greater than 2.75	1.9	-1.8	4.8	1.6
AER as % of revenue	Flexibility	*Greater than 15%	28%	20%	21%	23%

*guideline under review

Although the University finished the year with better financial results in 2009/10 than in 2008/09, the capacity and affordability ratios were still below the Debt Policy guidelines at year end.

Concept drawing of the new Centre for Primary Care, Aberdeen Ave and Longwood Rd., Hamilton

McMaster Niagara Family Health Centre, St. Catharines


McMaster Facullty of Health Sciences, Michael G. DeGroote School of Medicine, Waterloo Campus

McMASTER UNIVERSITY
ANNUAL FINANCIAL REPORT
2009/10

FINANCIAL STATEMENTS – APRIL 30, 2010

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McMaster University

Photo: Atrium of Burlington Ron Joyce Centre

McMaster University

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, 2010 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. All 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, 2010 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.

Vice-President, Administration
July 30, 2010

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, 2010 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, 2010 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
July 30, 2010

McMASTER UNIVERSITY
Statement of Financial Position
April 30, 2010, with comparative figures for 2009
(thousands of dollars)

	2010	2009
Assets		
Current assets:		
Cash and equivalents	$ 170,506	$ 76,182
Government grants and other accounts receivable	58,237	62,920
Research grants receivable	76,933	69,486
Inventories	5,405	5,642
Prepaid expenses	5,378	5,001
Loan receivable (note 2)	-	15,963
	316,459	235,194
Investments (note 3)	573,779	563,211
Investment in McMaster Innovation Park (note 2)	13,318	13,318
Capital assets (note 4)	715,161	683,777
Deferred pension asset (note 5)	212,108	220,811
	$ 1,830,825	$ 1,716,311
Liabilities, Deferred Contributions and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 118,511	$ 116,730
Deferred revenue	37,457	36,772
Current portion of long-term obligations (note 6)	1,128	1,060
	157,096	154,562
Accrued employee future benefits (note 5)	245,250	224,891
Long-term obligations (note 6)	163,134	165,775
Deferred contributions (note 7):		
Deferred for future expenses	303,423	282,679
Deferred capital contributions	332,668	314,333
	636,091	597,012
Net assets:		
Unrestricted	2,174	(146)
Internally restricted (note 8):		
Employee future benefits	(61,692)	(36,188)
Specific purpose	59,952	45,982
Equity in capital assets (note 9)	233,149	219,452
Endowments (note 10):		
Internal	107,817	98,832
External	287,854	246,139
	629,254	574,071
Commitments and contingencies (note 11)		
	$ 1,830,825	$ 1,716,311

On behalf of the Board of Governors:

____________________ Chair, Board of Governors

____________________ Chair, Audit Committee

See accompanying notes to financial statements

McMASTER UNIVERSITY
Statement of Operations
Year ended April 30, 2010, with comparative figures for 2009
(thousands of dollars)

	2010	2009
Revenues:		
Operating grants	$ 222,865	$ 208,673
Research grants and contracts	150,719	154,733
Tuition fees	154,696	141,323
Ancillary sales and services	68,756	65,602
Other (note 12)	98,187	94,682
Investment income (loss), net	48,748	(14,739)
Donations and other grants	33,817	28,799
Research overhead grants	14,199	15,600
Amortization of deferred capital contributions	36,386	37,146
	828,373	731,819
Expenses:		
Salaries and wages	381,926	365,091
Employee benefits	125,761	112,264
Supplies and services	236,593	235,724
Interest on long-term obligations	9,969	10,034
Amortization of capital assets	62,474	62,659
	816,723	785,772
Excess (deficiency) of revenues over expenses	$ 11,650	$ (53,953)

See accompanying notes to financial statements

McMASTER UNIVERSITY
Statement of Changes in Net Assets
Year ended April 30, 2010, with comparative figures for 2009
(thousands of dollars)

	Unrestricted	Internally restricted: Employee future benefits	Internally restricted: Specific purposes	Equity in capital assets	Endowments: Internal	Endowments: External	2010 Total	2009 Total
Net assets, beginning of year:	$ (146)	(36,188)	45,982	219,452	98,832	246,139	574,071	685,888
Excess (deficiency) of revenues over expenses	37,738	-	-	(26,088)	-	-	11,650	(53,953)
External endowment contributions:								
Contributions	-	-	-	-	-	8,608	8,608	24,132
Protection of capital	-	-	-	-	-	33,107	33,107	(79,853)
Transfers and adjustments:								
Transfers for specific purposes	11,534	(25,504)	13,970	-	-	-	-	-
Capital transactions from operating (note 9)	(39,785)	-	-	39,785	-	-	-	-
Transfer to internal endowments	(8,985)	-	-	-	8,985	-	-	-
Net change in unrealized losses on interest rate swap agreements (note 6)	1,818	-	-	-	-	-	1,818	(2,143)
	2,320	(25,504)	13,970	13,697	8,985	41,715	55,183	(111,817)
Net assets, end of year	$ 2,174	(61,692)	59,952	233,149	107,817	287,854	629,254	574,071

See accompanying notes to financial statements

McMASTER UNIVERSITY

Statement of Cash Flows

Year ended April 30, 2010, with comparative figures for 2009

(thousands of dollars)

	2010	2009
Cash flows from operating activities:		
Excess (deficiency) of revenues over expenses	$ 11,650	$ (53,953)
Adjustments for non-cash items:		
Amortization of deferred capital contributions	(36,386)	(37,146)
Amortization of capital assets	62,474	62,659
Increase in accrued employee future benefits	20,359	19,833
Increase in decommissioning obligation	306	291
Decrease in deferred pension asset	8,703	1,471
	67,106	(6,845)
Net change in contributions deferred for future expenses	20,744	27,128
Loan receivable	15,963	(15,963)
Net change in other non-cash working capital	(438)	14,903
	103,375	19,223
Cash flows from financing and investing activities:		
Purchase of capital assets	(93,858)	(101,692)
Net change in investments	(10,568)	50,809
Net change in external endowments	41,715	(55,721)
Deferred capital contributions	54,721	51,990
Principal repayments on long-term obligations	(1,061)	(998)
	(9,051)	(55,612)
Net increase (decrease) in cash	94,324	(36,389)
Cash and equivalents, beginning of year	76,182	112,571
Cash and equivalents, end of year	$ 170,506	$ 76,182

See accompanying notes to financial statements

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)
- Adiga Life Sciences Inc. (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:

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 derivatives embedded in contracts to buy or sell non financial items in accordance with the University's expected purchase, sale or usage requirements.

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.

(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 which is a reasonable estimate of net realizable value.

1. Significant accounting policies (continued):

(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%
Leasehold improvements	term of lease

(g) Collections and works of art:

The McMaster Museum of Art has significant collections of works of art and coins. Donations of works of art amounted to $269,000 (2009 - $49,000) 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.

(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.

1. Significant accounting policies (continued):

(j) Employee future benefits (continued):

- 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:

Unrestricted: operating funds available without specific restrictions.

Internally restricted:

- Employee future benefits: unfunded portion of pension and other non-pension retirement and post-employment benefits, net of funds set set aside to meet estimated future obligations.
- 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.

(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.

1. Significant accounting policies (continued):

(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 obligations.

(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) Change in accounting policies:

Effective May 1, 2009, the University adopted the Canadian Institute of Chartered Accountants (“CICA”) amendments to the following CICA Handbook sections:

- Section 1000, which clarified the criteria for recognition of an asset or liability, removing the ability to recognize assets or liabilities solely on the basis of matching of revenue and expense items;
- Section 4400 series, which made disclosure of equity in capital assets as a separate component of net assets optional, clarified the requirement for revenue and expenses to be presented on a gross basis when the not-for-profit organization is acting as principal and required a statement of cash flows;
- Section 4470 "Disclosure of Allocated Expenses by Not-for-Profit Organizations", which required certain disclosures when fundraising and general support expenses are allocated to other functions.

Adoption of these recommendations had no significant impact on the financial statements for the year ended April 30, 2010.

2. McMaster Innovation Park:

The First Longwood Innovation Trust and The Gore District Land Trust ("Park") were created by the University in 2006 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 2009	December 31 2008
Total assets	$ 72,711	$ 44,831
Total liabilities	$ 35,030	$ 15,558
Total deferred revenue and capital grants	24,363	15,955
Total trusts' equity	13,318	13,318
	$ 72,711	$ 44,831
Results of operations:		
Total revenue	$ 2,268	$ 1,321
Total expenses	2,268	1,321
Net earnings	$ -	$ -
Cash flows:		
From operating activities	$ 2,188	$ (485)
From financing and investing activities	(5,589)	(1,815)
Decrease in cash	$ (3,401)	$ (2,300)

In fiscal 2009, the University established a non-revolving loan facility bearing interest at prime less 0.25%. At April 30, 2009, outstanding draws and accrued interest were $15,963,350. In June 2009, the University also provided the Park with a non-revolving operating loan facility of up to $3 million under which the University provided cash advances bearing interest at prime plus 3%. These loans, totaling $18,700,000 plus interest of $698,724 were re-paid during fiscal 2010. The University is party to a Debt Service Deficiency Agreement as disclosed in Note 11(c).

Included in accounts receivable at April 30, 2010 is $118,226 (2009 - $49,128) receivable from the Park.

In fiscal 2009, the Park 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.

In addition to the information disclosed elsewhere, the University had the following related party transactions with the Park for their year ended December 31, 2009:

- provided payroll services at a fee (1% of total salaries paid) which amounted to $6,845 (2008 - $3,519);
- paid rent in the amount of $368,870 (2008 - $99,964).
- received rent free space from the Park with an estimated fair value of $245,000. The parties are negotiating the terms of a rental agreement for fiscal 2011.

3. Investments:

Details of investments are as follows:

(thousands of dollars)	2010		2009	
	Fair Value	Cost	Fair Value	Cost
Equities:				
Canadian	$ 121,891	$ 105,564	$ 93,007	$ 100,454
United States	104,136	107,922	76,181	92,050
Non-North American	80,365	100,920	70,122	99,045
	306,392	314,406	239,310	291,549
Fixed income	$ 260,172	$ 256,675	$ 314,677	$ 311,121
Other	7,215	10,078	9,224	9,676
	$ 573,779	$ 581,159	$ 563,211	$ 612,346

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	2010 Net
Land	$ 3,494	$ -	$ 3,494
Buildings	791,191	256,814	534,377
Decommissioning retirement costs	213	43	170
Site improvements	13,343	6,085	7,258
Leasehold improvements	191	57	134
Library materials	127,313	97,533	29,780
Equipment, furnishings and vehicles	341,226	277,094	64,132
Computing systems and computing equipment	112,773	92,866	19,907
Construction in progress	55,909	-	55,909
	$ 1,445,653	$ 730,492	$ 715,161

(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

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)	2010			
	Pension			
	Registered	Supplemental	Other	Total
Accrued benefit obligation	$ 1,332,688	$ 79,269	$ 214,560	$ 1,626,517
Fair value of plan assets	1,036,572	-	-	1,036,572
Funded status - deficiency	(296,116)	(79,269)	(214,560)	(589,945)
Reconciliation to deferred benefits (accrued future benefits):				
Unamortized past service cost	(2,952)	1,767	-	(1,185)
Unamortized actuarial loss	511,176	13,789	33,023	557,988
Deferred pension asset	$ 212,108	-	-	$ 212,108
Accrued employee future benefits	-	(63,713)	(181,537)	(245,250)
	$ 212,108	$ (63,713)	$ (181,537)	$ (33,142)

(thousands of dollars)	2009			
	Pension			
	Registered	Supplemental	Other	Total
Accrued benefit obligation	$ 1,171,592	$ 75,511	$ 194,946	$ 1,442,049
Fair value of plan assets	874,080	-	-	874,080
Funded status - deficiency	(297,512)	(75,511)	(194,946)	(567,969)
Reconciliation to deferred benefits (accrued future benefits):				
Unamortized past service cost	(3,212)	2,121	-	(1,091)
Unamortized actuarial loss	521,535	12,019	31,426	564,980
Deferred pension asset	$ 220,811	-	-	$ 220,811
Accrued employee future benefits	-	(61,371)	(163,520)	(224,891)
	$ 220,811	$ (61,371)	$ (163,520)	$ (4,080)

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

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

(thousands of dollars)	2010		2009	
	Pension	Other	Pension	Other
Net benefit expense	$ 58,357	$ 22,992	$ 45,588	$ 24,223

5. Employee future benefits (continued):

(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	63%	65%	8.3%
Debt securities	36%	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	6.00%	6.00%
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	7.50%	7.50%
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)	2010		2009	
	Pension	Other	Pension	Other
Employer contributions	$ 47,314	$ 4,975	$ 43,917	$ 4,588
Employee contributions	15,224	-	14,022	-
Benefits paid	54,558	4,975	57,638	4,588

(g) For measurement purposes, a 6.95% annual rate of increase in per capita medical cost was assumed for 2010, grading down to 4.5% per annum in and after 2030. For per capita dental costs, an annual rate of increase of 4.5% per annum was assumed.

(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, 2010.

The results of each valuation have been extrapolated to April 30, 2010, 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 2010 amounted to $94,000 each (2009 - $11,000).

6. Long-term obligations:

Details of long-term obligations are as follows:

(thousands of dollars)	Maturity	Interest Rate	Current portion	Non-current portion	2010 Total Outstanding	2009 Total Outstanding
Long term debt:						
Residence mortgage (a)	May 2011	9.81%	$ -	$ 11,544	$ 11,544	$ 11,544
Bank loan (b)	Dec 2012	floating	646	1,170	1,816	2,422
Mortgage	Oct 2016	5.38%	107	702	809	911
Bank term loan (c)	May 2033	floating	375	18,726	19,101	19,454
Debentures (d)	Oct 2052	6.15%	-	120,000	120,000	120,000
			1,128	152,142	153,270	154,331
Decommissioning obligation (e)			$ -	$ 6,300	$ 6,300	$ 5,994
Interest rate swap agreements (f)			-	4,692	4,692	6,510
			$ 1,128	$ 163,134	$ 164,262	$ 166,835

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

2011	$ 1,128
2012	12,744
2013	1,028
2014	580
2015	616

(a) A voluntary 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 $5,947,000 (2009 - $5,149,000).

(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%.

(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 $9,622,000 (2009 - $8,205,000).

(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, 2010, the fair value of the trust funds amounted to $6,030,000 (2009 - $4,798,000). The net present value of the estimated cost for decommissioning, at April 30, 2010 is $6,300,000 (2009 - $5,994,000) using a risk free rate of 5.1%.

6. Long-term obligations (continued):

(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)	2010		2009	
	Notional Value	Fair Value	Notional Value	Fair Value
10-year interest rate swap	$ 1,816	$ (107)	$ 2,423	$ (235)
30-year interest rate swap	19,101	(4,585)	19,454	(6,275)
	$ 20,917	$ (4,692)	$ 21,877	$ (6,510)

The change in fair value of the swaps for the year ended April 30, 2010 are as follows:

- 10-year: $128,000 (2009 - ($53,000))
- 30-year: $1,690,000 (2009 - ($2,090,000))

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)	2010	2009
Balance, beginning of year	$ 282,679	$ 255,551
Deferred and capital contributions received	272,969	279,887
	555,648	535,438
Less:		
Amounts recognized as revenue	(197,504)	(200,769)
Deferred capital contributions transfer	(54,721)	(51,990)
Balance, end of year	$ 303,423	$ 282,679

Deferred contributions consist of the following:

(thousands of dollars)	2010	2009
Research grants and contracts	$ 177,114	$ 159,095
Donations, other grants and investment income	65,063	72,125
Capital grants and donations	56,060	46,830
Other restricted funds	5,186	4,629
	$ 303,423	$ 282,679

7. Deferred contributions (continued):

(b) Deferred capital contributions:

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

(thousands of dollars)	2010	2009
Balance, beginning of year	$ 314,333	$ 299,489
Add: contribution transfers	54,721	51,990
Less: amount amortized to revenue	(36,386)	(37,146)
Balance, end of year	$ 332,668	$ 314,333

8. Internally restricted net assets:

(a) Employee future benefits:

Details of employee future benefits internally restricted net assets are as follows:

(thousands of dollars)	2010	2009
Pensions	$ 110,291	$ 120,090
Other retirement and post employment benefit plans	(171,983)	(156,278)
	$ (61,692)	$ (36,188)

(b) Specific purposes:

Details of specific purpose internally restricted net assets are as follows:

(thousands of dollars)	2010	2009
Unexpended departmental carryforwards	71,065	67,381
Research	11,086	12,688
Ancillaries	7,997	4,478
Other	28,250	16,957
	118,398	101,504
Sinking funds	15,569	13,370
Capital projects	(74,015)	(68,892)
	$ 59,952	$ 45,982

Included in unexpended departmental carryforwards is a $4,500,000 (2009 - $5,000,000) advance to the Faculty of Science from unrestricted net assets for which arrangements for recovery are in place.

8. Internally restricted net assets (continued):

(b) Specific purposes (continued):

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

(thousands of dollars) Project	Funding Source		2010 Balance
Engineering Building	Graduate funding, pledges, fundraising	$	(13,086)
Les Prince Residence	Ancillary operations		(18,829)
David Braley Athletic Centre	Student levies, pledges, fundraising		(14,510)
Stadium and Parking Project	Parking fees, pledges, fundraising		(27,835)
McMaster Biosciences Incubation Centre	Rental and other income		(101)
Michael DeGroote Centre for Learning, 2nd Floor	Graduate funding, pledges, fundraising		(5,953)
Ron Joyce Centre - Burlington	Fundraising, Region of Halton, City of Burlington		(12,966)
Internal Equipment Loans	Various		(273)
Other projects (net)	Various		19,538
		$	(74,015)

(thousands of dollars) Project	Funding Source		2009 Balance
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)

9. Equity in capital assets:

The equity in capital assets is calculated as follows:

(thousands of dollars)		2010		2009
Capital assets	$	715,161	$	683,777
Less amounts financed by:				
Net long-term debt		(149,344)		(149,992)
Unamortized deferred capital contributions		(332,668)		(314,333)
	$	233,149	$	219,452

Details of the transfer for capital transactions are as follows:

(thousands of dollars)		2010		2009
Repayment of long-term debt	$	1,061	$	998
Capital asset purchases from operating		38,724		49,702
	$	39,785	$	50,700

10. Endowments:

(a) Internal:

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

(thousands of dollars)	2010	2009
Balance, beginning of year	$ 98,832	$ 133,166
Donations	130	86
Investment income (loss)	16,696	(28,292)
Net transfers and expenses	(7,841)	(5,128)
Transfer to external endowments	-	(1,000)
Balance, end of year	$ 107,817	$ 98,832

Included in internal endowments is an amount of $51,827,000 (2009 - $46,509,000) reflecting the legacy of Dr. H. L. Hooker. The income generated from this capital is used to fund programs that enrich the academic achievements of the University as approved annually by the Board.

(b) External:

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

(thousands of dollars)	2010	2009
Balance, beginning of year	$ 246,139	$ 300,860
External contributions:		
OTSS	3,390	3,627
Other	5,218	20,505
Income retained (withdrawn) - capital protection policy	33,107	(79,853)
Transfer from internal endowments	-	1,000
Balance, end of year	$ 287,854	$ 246,139

In 2010, investment income on external endowments amounted to $40,200,000 (2009 - ($66,706,000)). In accordance with the endowment capital protection policy, this income less the amount made available for spending of $6,597,000 (2009 - $12,246,000) net of transfers of $496,000 (2009 - $901,000) were added to endowment net assets. The amount made available for spending is 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 approximately sixty 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.

11. Commitments and contingencies (continued):

(b) Legal claims (continued):

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 approximately $31 million, 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) Debt Service Deficiency Agreement:

The University has guaranteed the scheduled principal and interest payments, up to $23 million of long-term debt extended to The First Longwood Innovation Trust ("Park"), in the event of default. The total amount of debt outstanding and subject to the Debt Service Deficiency Agreement at April 30, 2010 was $20 million. Since the agreement may expire without being drawn upon, it does not necessarily represent future cash requirements. As of April 30, 2010, no obligation exists under the agreement and as a result, no amount has been recognized as a liability on the Statement of Financial Position.

(d) Capital commitments:

The estimated cost to complete approved major capital projects amounted to $115,085,000 at April 30, 2010 (2009 - $70,395,000).

(e) 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)		
2011	$	2,915
2012		1,905
2013		1,062
2014		203
2015		158

12. Other income:

Details of other income are as follows:

(thousands of dollars)	Major Sources		2010		2009
Faculty of Health Sciences	Government specifically funded programs	$	41,020	$	38,925
Other Faculties	Non-degree educational fees, international postgraduate stipends, space/equipment rentals, other student fees		24,898		26,857
Academic Services	Nuclear reactor sales, contracts and patent royalties, registrar administration fees		13,257		11,374
Student Services	Athletics and Recreation memberships and user fees		12,434		11,297
Miscellaneous	Application fees, late payment fees		6,578		6,229
		$	98,187	$	94,682

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 $458,000 (2009 - $915,000).
- Joint ventures: the University's share of income amounted to $273,000 (2009- $230,000).

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 2010. In addition, the University could 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, 2010 and 2009 in the first phase of the Ontario Student Opportunity Trust Fund (OSOTF I) balance:

(thousands of dollars)	2010	2009
Endowment balance, beginning of year	$ 29,406	$ 33,077
Investment income retained for (used from) protection of capital	1,414	(3,965)
Investment income transferred (to) from expendable income	(3)	294
Endowment balance, end of year	30,817	29,406
Funds available for awards, beginning of year	-	-
Investment income	320	1,254
Bursaries awarded (2010 - 254 awards; 2009 - 905 awards)	(323)	(960)
Investment income transferred from (to) endowment balance	3	(294)
Funds available for awards, end of year	-	-
Total funds at book value	$ 30,817	$ 29,406

The market value of the endowment as at April 30, 2010 was $28,438,000 (2009 - $24,828,000).

15. Ontario student opportunity trust fund (continued) :

(b) Ontario Student Opportunity Trust Fund - Phase II

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

The following is the schedule of changes for the years ended April 30th:

(thousands of dollars)	2010	2009
Endowment balance, beginning of year	$ 5,468	$ 6,097
Investment income retained for (used from) protection of capital	205	(629)
Endowment balance, end of year	5,673	5,468
Funds available for awards, beginning of year	30	22
Investment income for expenditures	60	205
Bursaries awarded (2010 - 67 awards; 2009 - 209 awards)	(59)	(197)
Funds available for awards, end of year	31	30
Total funds at book value	$ 5,704	$ 5,498

The market value of the endowment as at April 30, 2010 was $5,531,000 (2009 - $4,738,000).

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.

The following is the schedule of changes in the endowment balance and expendable funds for the thirteen months ended April 30, 2010 and the year ended March 31, 2009:

(thousands of dollars)	2010	2009
Endowment balance, beginning of year	$ 21,976	$ 17,040
Cash donations received	1,515	1,670
Funds received/receivable from MTCU	1,927	2,007
Investment income retained for (used from) protection of capital	128	1,259
Endowment balance, end of year	25,546	21,976
Funds available for awards, beginning of year	750	630
Investment income for expenditures	221	656
Bursaries awarded (2010 - 31 awards; 2009 - 221 awards)	(152)	(536)
Funds available for awards, end of year	819	750
Total funds at book value	$ 26,365	$ 22,726

The market value of the endowment as at April 30, 2010 was $22,779,000 (March 31, 2009 - $18,070,000).

17. First Generation Pilot Project Initiatives:

For the period from January 1, 2009 to March 31, 2010, the University's financial statements include expenditures totaling $207,992 for the purpose of carrying out the First Generation Pilot Project Initiatives. Between April 1, 2010 and June 30, 2010, an additional $5,800 was spent on this program and will be included in fiscal 2011. The goal of this project is to increase the awareness of the benefits of post-secondary education of first generation students thereby increasing their participation, retention and graduation rates.

18. Pledges receivable:

Outstanding but unrecorded pledges for donations and other fund raising amounted to $92,674,000 (2009 - $77,299,000).

19. Fair value of financial instruments:

The carrying value of cash and equivalents, government grants and other accounts receivable, research grants receivable and accounts payable and accrued liabilities approximates their fair values based on the the short-term maturity of these instruments.

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

(thousands of dollars)	2010		2009	
	Book Value	Fair Value	Book Value	Fair Value
Long term debt:				
- with fixed interest rates	$ 132,353	$ 144,167	$ 132,455	$ 135,995
- with variable interest rates (without consideration of interest rate swaps)	20,917	20,917	21,876	21,876

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).

20. Comparative figures:

Certain comparative figures for 2009 have been reclassified to conform with the financial statement presentation adopted in the current year.

Supplemental Information: Operating Fund and Operating Budget

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

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

Fund accounting enhances accountability and budgetary control of resources by ensuring that restricted grants and contributions are spent only for the purposes intended. To maintain control, the following segregated funds have been developed: 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 60% of all spending. In 2009/10 the Operating Fund Budget included benefit rates that fully recognized the current service costs for pensions, and a portion of future costs of post retirement benefits. Over 50% ($4.6 million) of the required special payments for the salaried pension plan deficit in 2009/10 were funded through operations and the remainder was funded from reserves.

Considerable attention and effort was focused on addressing the budgeted deficit and the University finished the year with a small (0.8% of revenue) surplus as shown in the chart below.

	2009/10 OPERATING FUND ($ millions)				
				Variance	
	Budget	Projection	Actual	Budget vs. Actual	Projection vs. Actual
Sources of revenue	$ 427.3	$ 457.8	$ 461.4	$ 34.1	$ 3.5
Less net expenditures	453.6	469.5	451.9	1.7	17.6
Excess (deficiency) of revenue over net expenditures	(26.4)	(11.7)	9.4	35.8	21.1
Add amount charged to unrestricted net assets	(0.5)	(0.5)	(0.5)	–	–
Transfers from (to) other funds	–	(6.2)	(5.2)	(5.2)	0.9
Net surplus (deficit)	(26.9)	(18.4)	3.7	30.5	22.1
Fund balance, beginning of year*	67.4	67.4	67.4	–	–
Fund balance, end of year	$ 40.5	$ 49.0	$ 71.1	$ 30.5	$ 22.1

*adjusted to actual

Total operating fund revenues were $461.4 million as compared to the projected funding of $457.8 million. The favourable variance of $3.5 million (0.8%) is primarily due to increased other income including OUAC fees and interest on student accounts.

The favourable revenue variance of $34.1 million (8.0%) compared to original budget is primarily due to:

- increased Provincial funding ($14.9 million), including Accessibility ($5.3 million), graduate expansion (1.0 million), medical grants ($5.9 million), and one-time Quality ($2.5 million);
- greater than expected tuition ($3.0 million);
- research overhead income ($0.7 million);
- investment income earned on working capital balances ($1.7 million); and
- other income ($13.8 million).

Operating fund expenditures net of transfers and recoveries were $451.9 million as compared to projected net expenditures of $469.5 million. The favourable variance of $17.6 million (3.7%) is primarily the result of delayed and reduced spending by departments as they seek to align their operations with available resources and known limited allocations in the subsequent years.

Transfers to other funds represent operating funds earmarked for capital projects, offset by contributions to operations from ancillary operations. The favourable variance compared to projection of $0.9 million (14.5%) was due to lower transfers to capital plus additional ancillary contributions. These transfers were not separately identified in the original budget.

The remaining surplus of $3.7 million has been transferred to internally restricted net assets (department appropriations) which results in closing appropriations of $71.1 million, up from $67.4 million at April 30, 2009. Appropriations are available to provide funds to offset one-time spending and investments in deficit-reducing strategies.

Students collaborating in the atrium and lounge, Ron Joyce Centre, McMaster Burlington Campus

Annual Financial Report 2009/2010

McMaster University

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