McMaster University

2004/05 Annual Financial Report

Management's Discussion and Analysis of Financial Condition

Measuring our Performance 2004/2005

Table of Contents

McMaster University

Measuring our Performance - 2004/2005

Executive Summary

Year after year, McMaster University is acknowledged as one of the most innovative universities in Canada. In November 2004, McMaster was named 'Canada's Research University of the Year' by Research Info Source Inc. We have a proven ability to link scholarship and teaching and continuously strive for excellence as a student-centered, research-intensive university.

In 2004/05, the quality of McMaster's academic and research programs was evidenced by further increases in its proportion of demand from highly-qualified students and increases in research grants and contracts. The University has achieved its growth targets with increases in full time equivalent student enrolment of over 5% and growth in research grants and contracts earned revenue of almost 12%. McMaster's entering students are among the most highly qualified in the province. McMaster again had the 3rd highest percent of students entering an Ontario University with an average entering grade of greater than 80%.

2004/05 marked the opening of the Michael DeGroote Centre for Learning and Discovery, a state of the art building that provides technologically advanced classroom space to house more than 250 scientists, and will help put Canada on the international research map. In pursuit of its goal to achieve the next level of research, McMaster acquired 37.5 acres of land to begin the creation of the McMaster Innovation Park. Financing of the acquisition of land for the McMaster Innovation Park was completed using internal funds. Municipal and provincial grants of $15 million have been received and deferred to aid in the future demolition and development of the park.

The $120 million in senior unsecured 50-year debentures were issued October 7, 2002 and proceeds from the debentures have been used to invest in academic and research facilities on campus with the unspent amount of $ 31 million being allocated to planned capital needs. The sinking fund set up for repayment of the principal when the debenture matures in 2052 now stands at $8.3 million. The November 2004 rating from DBRS confirmed the AA rating citing 'moderate debt levels and sound operating results despite ongoing cost pressures'.

McMaster continued to produce strong financial results in 2004/05. Operating grants and tuition fees increased by 7.3% and 4.0% respectively while the increase of 4.1% in research overhead grants from the Federal Indirect Cost of Research Fund increased revenue from research overhead grants to $13.2 million. Investment income at $36.1 million is down from the turnaround high of $56.6 million in the previous fiscal year. Net rate of return on long term investments for the year ended April 30 was 7.37%. Receipts of donations and other grants of almost $64 million are evidence of another successful year of fundraising.

Expenses increased by 13.0% during the year with the largest percent increase occurring in the employee benefits costs which increased from $38.4 million to $67.6 million, leaving an excess of revenues over expenses for the year of $6.1 million compared to $47.9 in 2003/04. After transfers to net assets invested in capital assets and internally restricted endowments of $25.8 and $2.1 million respectively, and transfers from unrestricted reserves of $25.7 million, unrestricted net assets increased by $4.0 million for the year compared to an increase of $6.7 million in 2003/04. The accumulated unrestricted net assets balance of $14.0 million and expendable reserves of approximately $39 million are available to provide future financial stability. Approximately $6 million of this balance has been identified for use in the fiscal 05-06 budget to provide bridge financing to a specific department that is carrying forward an accumulated deficit. This bridge financing will be repaid to unrestricted net assets from future operations.

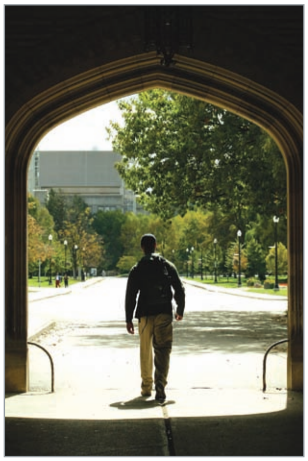
Total assets of the University increased by 6.7% to $1.4 billion during the year. Current assets decreased approximately 9% during the year, due primarily to an increase in long-term investments of the University and continued expenditure of the proceeds from the debenture issue. Expenditures on capital assets during the year were $102.9 million, with completion or substantial progress on a number of new or expanded buildings, including acquisition of 37 acres of land for development of an Innovation Park. After amortization for the year of $53.7 million, net capital assets increased by $49.2 million to $515.5 million.

Deferred contributions increased by $14.1 million to $493.9 million reflecting both an increase in grants, donations and research contracts.

Externally restricted endowments received during the year were significant at $40.3 million, due mainly to the receipt of the second installment of the unprecedented gift of $105 million from Michael G. DeGroote.

This commentary and the attached audited financial statements, prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP), show the year over year progress McMaster has made in achieving its goal of creativity, innovation and excellence in teaching and scholarship.

This commentary includes forward-looking statements which may involve, but are not limited to, comments with respect to the University's future objectives, strategies, targets or results. Readers of this commentary are advised not to place undue reliance on the forward-looking statements as a number of factors could cause actual future results to differ from the expectations or intentions expressed in the forward-looking comments. Future outcomes may be influenced by many factors, including but not limited to the critical risks identified by the University in its Enterprise Wide Risk Management program, further discussed on page 18 of this report.



McMaster

Mission, Vision, Goals and Targets

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.

Strategic Goals approved by the Board of Governors in June 2003

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

In order to sustain the academic mission of the University a strong financial position is required. The University has identified four key financial performance goals outlined below. This MD&A measures our 2004/05 performance against these goals.

Financial Performance Goals

- To achieve strong demand for McMaster programs and consistently achieve student enrolment targets
- To grow and diversify the revenue base
- To strategically deploy resources into priority areas
- To strengthen the financial position of the University and manage business risks

Strategic Planning and Management – *Refining Directions*

In 1995/96, the University undertook a comprehensive strategic planning process designed to establish the "direction" for the future success and prosperity of the University. The resultant document, published in December 1995 and entitled ***Directions*** outlines a clear mission and vision for McMaster and defines the basic goals and guiding planning principles that continue to shape the future of the University.

The ***Directions*** strategic plan complemented by the Academic Plan, the strategic priorities exercise and more recently the Graduate Education Plan and the Campus Plan have guided the University through challenging financial periods and allowed McMaster to move quickly to take advantage of new research and educational opportunities.

The ***Refining Directions*** strategic planning exercise, was launched in the fall of 2002 with the dual objectives of evaluating the University's success in meeting the goals established in ***Directions*** and constructing a strategic framework that would guide the University's course for the next five to ten years.

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

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

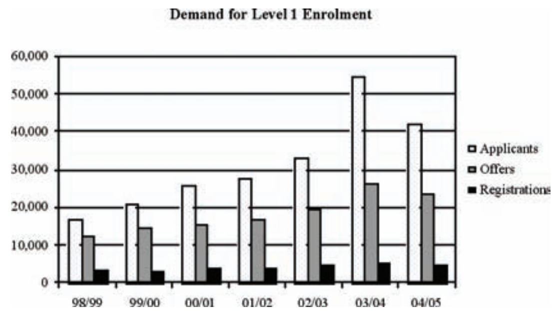
Implementation of ***Refining Directions*** is underway and detailed implementation work plans that include specific initiatives, targets, performance indicators, timelines and evaluation criteria were developed in 2004. In 2005 the process to align resources with these initiatives and to monitor progress in their achievement was initiated.

At the institution level, the University has implemented a planning, budgeting and control system governed by the University Planning Committee ("UPC"). The goals of this system are to integrate academic, strategic and financial planning institution-wide and to ensure fiscal accountability at all levels of the organization through aligning resources and management responsibilities. UPC has overall responsibility for implementing ***Refining Directions***. 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.

2004/05 Key Financial Indicators

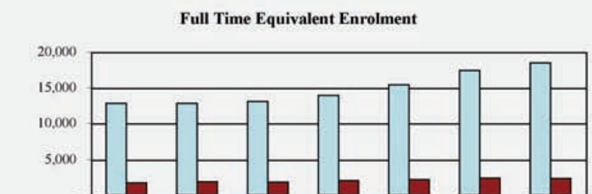
Achieve Strong Demand for Programs

- In 2004/05, as expected, Ontario universities experienced a decrease in Level 1 applications. McMaster's 22.6% decrease from 2003/04, the double cohort year, was similar to the provincial decrease.
- Compared to 2002/03, McMaster experienced an application increase of 26.6%. The proportion of students naming McMaster as their first choice increased by 17.8% since 2003/04.
- The % of students who accepted offers made by McMaster was relatively flat at 19.5% (19.8%-2003/04).



Achieve Targeted Enrolment Levels

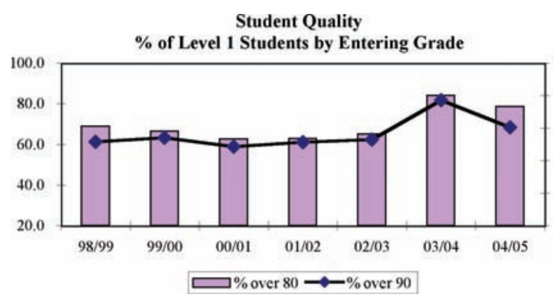
- 5.2% annual increase in total 04/05 full time equivalent (FTE) enrolment to 20,808 FTE's. Enrolment is ahead of target by 0.7%.
- 6% growth in undergraduate enrolment, slightly offset by a 1.9% decrease in graduate enrolment continued to provide access to a McMaster education to a growing number of quality students.



	98/99	99/00	00/01	01/02	02/03	03/04	04/05
Undergrad	12,794	12,767	13,054	13,895	15,406	17,388	18,463
Grad	1,727	1,870	1,805	2,035	2,185	2,389	2,344

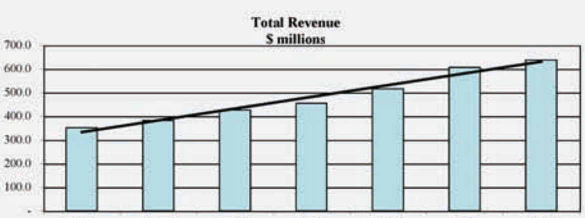
Attract High Quality Students

- In 2004/05 McMaster, like the Ontario aggregate, has experienced a decrease in student quality when compared to the 2003/04 double cohort year. Average entering grade in 2004/05 year was 83.7%, which is the 3rd highest in the province.
- The percentage of Level 1 students with an entering average greater than 80%, while still well above 2002/03, has decreased from 84.2% in 2003/04 to 78.5%.



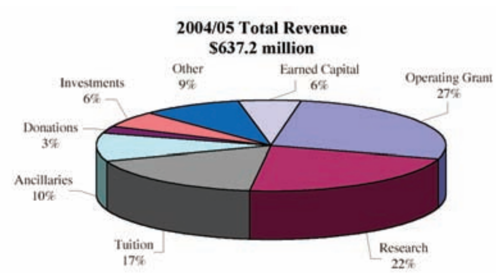
Grow the Revenue Base

- $31 million or 5% annual growth in 2004/05 total revenue reflects increased student enrolment and strong growth in revenue generating activities, offset by a decline in investment income.
- Total revenue has grown steadily over the past 7 years and is up by 81.3% over 1998/99 levels.
- Revenue per FTE at $30.6K is consistent with last year.



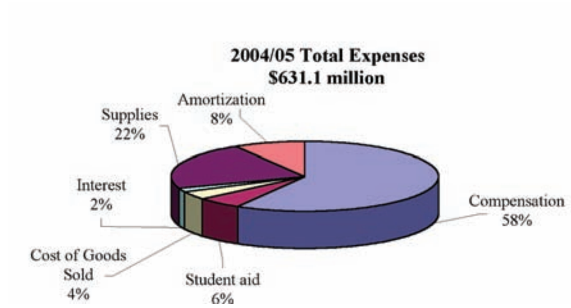
Diversify the Revenue Base

- McMaster continues to have a well diversified revenue base which provides reduced dependency on any one revenue source and is an important source of future financial stability.
- Percentage of revenue received from operating grants increased from 2003/04 mainly as a result of volume related increases in the provincial grant and tuition freeze compensation received from the Province.



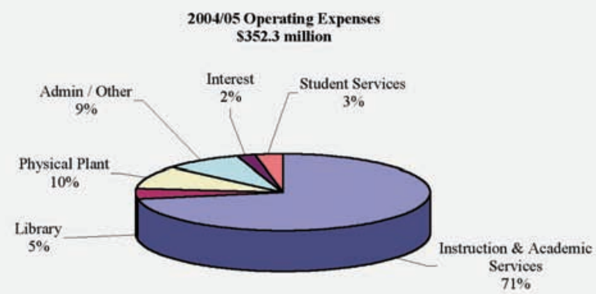
Strategic Deployment of Resources

- Total expenses are up by $72.8 million or 13.0%, due mainly to growth in enrollment (5.2%), research (12%), and compensation expenses.
- Compensation costs are up by 15.1% mainly due to the increased costs of employee future benefits. 2005/06 will continue to focus on multi-year financial planning to manage the risk of increases in employee future benefit long term liability.



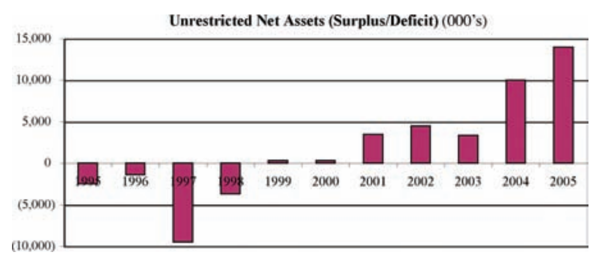
Strategic Deployment of Resources

- 71% of operating expense is invested into instruction and academic services in 2004/05, consistent with prior years.
- The proportion of operating expenditures made in student services and library remained relatively steady at 3% and 5% respectively.
- Investment in a 4% growth of new faculty and staff was made to provide capacity to meet academic and research volume increases.



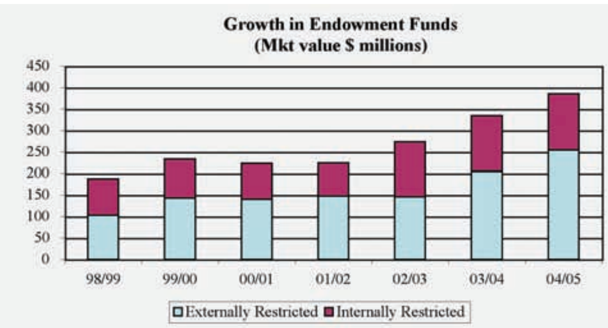
Strengthen Financial Position – prudent approach to financial management

- Conservative budgeting, planning and financial risk management has resulted in a net surplus position of $14.0 million as at April 30, 2005.
- The in-year increase of $4.0 million in unrestricted net assets is due to volume related revenue and investment income greater than budget, partially offset by additional utilities and general expenses.



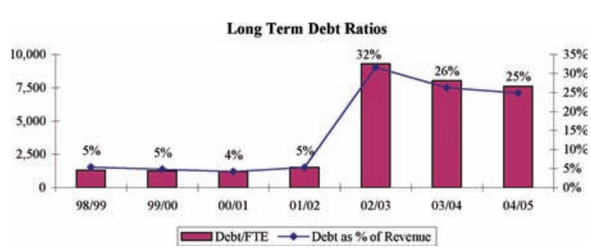
Strengthen Financial Position - continued growth in endowment funds

- At April 30, 2005, the market value of all endowment funds was $385.5 million, up 15.6% from the previous year. Endowment per FTE student of $18,500 is up by 9.6% compared to last year.
- Externally restricted endowments (including deferred donations) increased by 24.0%.
- 2004/05 return on long term assets was 7.37%.



Manage Business Risks – long term debt

- Long term debt of $158.0 million is down marginally from 03/04 as no new financing was utilized.
- Long term debt per student at $7,593 is down from the 2003/04 value of $8,027 due to unchanged borrowing and increased FTE's.
- Sinking funds of $10.6 million mitigate debt financing risk of which $8.3 million is available to repay the $120 million debenture principal in 2052.



Achieve Strong Demand for McMaster's Programs and Consistently Achieve Student Enrolment Targets

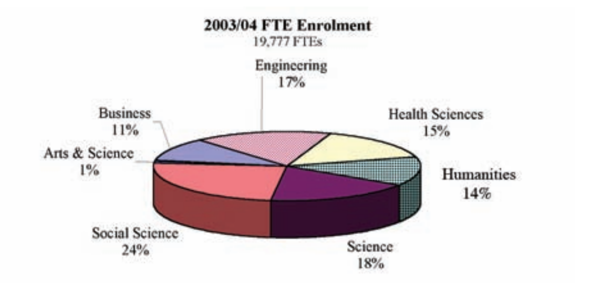
Over the past two years, McMaster has experienced an increase in demand for its programs in excess of the Ontario average. Applications to McMaster, received in 2003/04 for the 2004/05 year were down by 22.6% which is similar to the Ontario aggregate decrease. Beginning with applications to the 2004/05 academic year, high school students incurred higher costs when making applications due to the changes in the application process instituted by the Ontario Universities' Application Centre. Thus, students 'self selected' themselves from making applications to many universities. That is, students often only applied to those universities for which there was a realistic possibility that they would be accepted. The percentage of McMaster offers that were accepted remained relatively flat in 2004/05 at 19.5% compared with 19.8% in the prior year. Looking forward to 2005/06, while applications are down, the rate at which applicants have accepted admission is up.

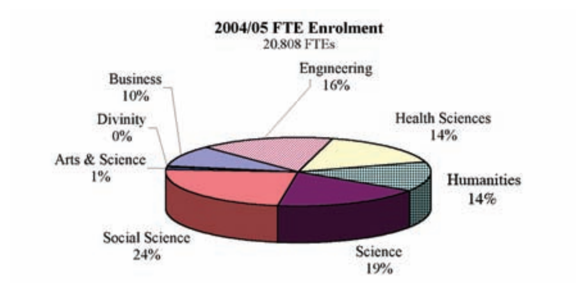
McMaster's culture of innovation in linking teaching and scholarship and its reputation for problem based learning and inquiry-based programs continues to be a strong attraction for high quality students. Although the overall entry grade for students coming directly from Ontario secondary schools decreased from 85.0% in 2003/04 to 83.9% in 2004/05, McMaster ranks third highest in the province and 2.5 percentage points above the Ontario aggregate average.

Excluding the double-cohort year of 2003/04, it is important to note that, while the Ontario aggregate increased by .4 percentage points from 2002/03 to 2004/05, McMaster experienced a significantly higher increase of 1.4 percentage points, moving from 82.5% to 83.9%. McMaster's percentage of Level 1 students with an entering average of greater than 80% decreased from 84.2% in 2003/04 to 78.5% in 2004/05. These results still indicate strong improvements in quality compared to the Ontario aggregate. McMaster's 2004/05 percentage of Level I students with an entering grade over 80% of 78.5% is up from 67.6% in 2002/03 compared to the system which increased from 58.0% of Level I to 60.2% in the same time period.

Full time equivalent (FTE) enrolment in 2004/05 increased by 5% over the previous year and over 42% compared to the enrolment level in 1998/99 reflecting the alignment of Provincial government initiatives with McMaster's commitment to provide access to post secondary education to a growing number of qualified students.

Student enrolment in 2004/05 continues to be well distributed through the University's six Faculties. The chart below illustrates this breakdown and includes the very popular Arts and Science program and students enrolled at the McMaster University Divinity College (less than 1% in 2004/05).





Growth and Diversification of the Revenue Base

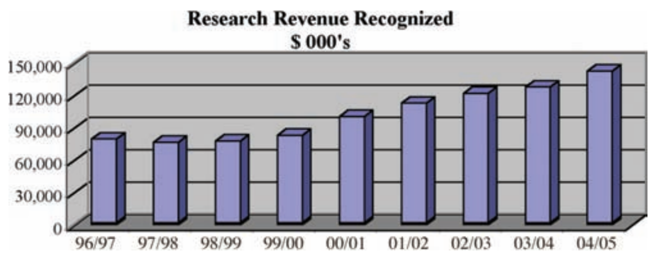
In 2004/05, the University's revenues grew to $637.2 million, growth of 5% over 2003/04. McMaster's reliance on government grants increased slightly at 27% of total revenue compared to 25% in 2003/04, down from 29% in 1998/99. The University's ability to further diversify the revenue base in 2004/05 was limited by the provincial freeze on tuition fee increases. Total revenue over that time period has increased by over 83%. Diversification of the funding base has been achieved through continued increases in research funding and other sources of income generated by faculties, non-academic areas, fund-raising and ancillary operations. Total revenue per FTE enrolment of $30.6K per FTE student is consistent with 2003/04.

Operating Grants Income

Provincial government operating grants of $149.8 million have increased by 7.3% over last year. Increases in provincial operating grants relate almost entirely to accessibility funding of enrolment growth, including post doctoral medical education, and the introduction of funding to compensate for the extended tuition freeze.

Research Grants and Contracts

Increases in research revenue recognized over the past several years have been dramatic and illustrate McMaster's success in creating internationally recognized centers of research excellence, building the infrastructure to support strategic research areas and integrating scholarship with teaching. In 2004/05, revenue for sponsored research increased 12% compared to 2003/04. This revenue has been an important driver in the University's total revenue growth and diversification. In terms of research intensity, McMaster was ranked as the number one research university in Canada in November 2004.



In accordance with GAAP, research revenue is recognized on the Statement of Operations in the year in which the expenditure occurs. Research revenue received, and not spent is deferred for future use and is recorded as Deferred Contributions on the Statement of Financial Position. Research funding of $162.9 million was received in 2004/05 and $22.3 million of that amount has been deferred for future use. While a significant portion of McMaster's research is supported by federal and provincial grants, over 40% is funded by other sources including non-government grants and contracts from corporations, foundations, associations and societies.

University Research Funding Received

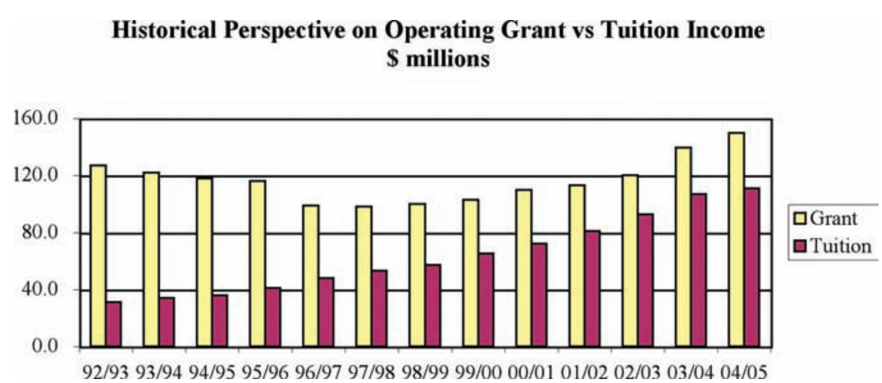
	Fiscal Year Ended April 30, 2005 ($ millions)	%
Federal Government	$ 69.2	42%
Province of Ontario	26.0	16%
Other Sources	67.7	42%
Total Research Funds Received	$ 162.9	100%
Less amount deferred to future periods	(22.3)	
Total Research Revenue Recognized	$ 140.6	

Research Overhead Grants

Research overhead grants assist the University in funding the indirect costs of research. In 2004/05, $13.2 million was received compared to $12.7 million in 2003/04. The Province and the Federal Government fund a portion of overhead costs associated with the federal research granting councils and eligible provincial research programs.

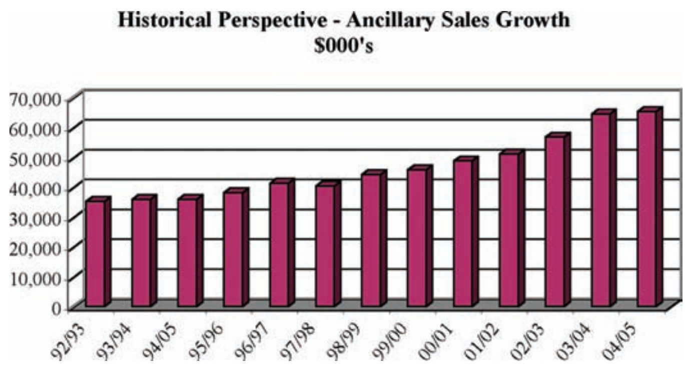
Tuition Fees

Revenue from tuition fees has increased by 4% in the fiscal year, as a result of a 5.2% growth in FTE students, partially offset by a slight change in mix toward proportionately greater undergraduate students. Domestic tuition fees remained frozen by the Province at prior years' levels in 2004/05.



Ancillary Operations

The University's ancillary operations have a mandate to provide excellent services, operate at break-even and cover all operating and capital costs through revenue earned. In addition, the Bookstore and Hospitality Services continue to provide a substantial contribution in support of essential soft Student Services. Sales by ancillary operations grew slightly (1.2%) to $65.2 million in 2004/05 after fairly significant growth in 2003/04.



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

Sales by Ancillary Operations

$ thousands	2004/05	2003/04	% Increase/(Decr)
Bookstore	20,742	20,941	-1.0%
Hospitality Services	15,626	15,472	1.0%
Housing and Conference Services	14,404	13,880	3.8%
Printing	5,312	5,711	-7.0%
Parking	3,432	3,205	7.1%
Continuing Education	2,311	2,098	10.2%
Telecommunications	1,185	1,228	-3.5%
Student Health Services	2,016	1,745	15.5%
Miscellaneous	136	125	8.8%
Total Ancillary Operations	**65,164**	**64,405**	**1.2%**

Parking revenue benefited from the increased enrolment and staff complement and rate increases instituted as part of a plan to manage on-campus parking demand. Bookstore sales were negatively impacted by the flood in the Health Sciences Bookstore.

Hospitality generated additional revenue growth from two successful units- Café One and Bridges, partially offset by a reduction in the number of meal plans sold.

Investment Income

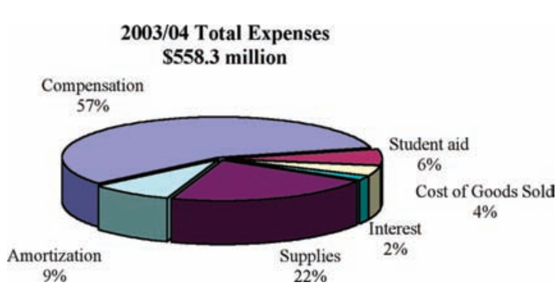
Investment income, recognized on the Statement of Operations for the year was $36.1 million compared to $56.6 million in 2003/04. The 2004/05 performance reflects the more typical investment markets compared to last year, and yielded an increase in market values of $27.9 million. A change in one of the University's fund managers resulted in the need to liquidate assets and a reduction to net realized investment income ($8.1 million) over the prior year.

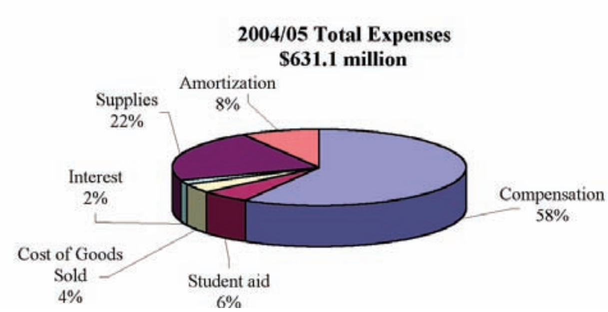
Investment returns generated from endowments are used in accordance with the designated purposes set out by either the donors or the Board of Governors. The University set the amount of annual income budgeted for expenditure on designated uses in 2004/05 at a maximum of 4.5% of the 3-year average market value of endowment capital. The policy has been reviewed and approved by the Board of Governors and the expenditure rate has been set at 4% from 2005/06 forward. In 2004/05, approximately 3.5% (3.5% in 2003/04) of the University's expenses were funded through endowment income, a significant proportion of which was directed towards student scholarships and bursaries and support of direct faculty expenses.

Other Sources of Revenue

Other sources of revenue include the recognition in revenue of $25.1 million of the $64.0 million of donations and other grants received in 2004/05, and the $59.2 million of revenue earned through various non-degree educational and other revenue-generating activities. The realization of $36.9 million of earned capital contributions equivalent to the amortization of capital assets funded through deferred contributions is also reflected in income.

Strategic Deployment of Resources



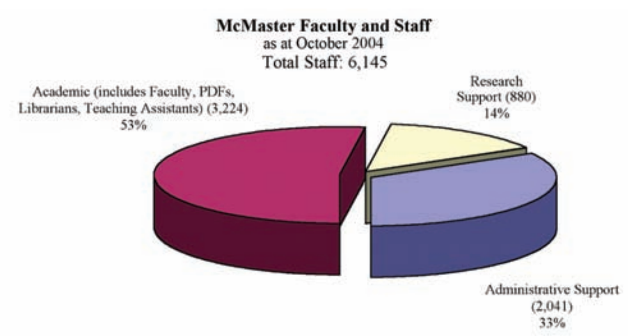


Expenses for 2004/05 were $631.1 million, representing an increase of 13.0% over 2003/04.

Compensation expenses as a percentage of total expenses increased slightly from approximately 57 % to 58% due to increased employee benefit costs. The proportion of expenses related to student aid remained constant at 6%, as did the proportion (22%) related to supplies and other expenses. On a functional basis, over 70% of total expenditures are invested into instruction and academic services and other programs.

Compensation

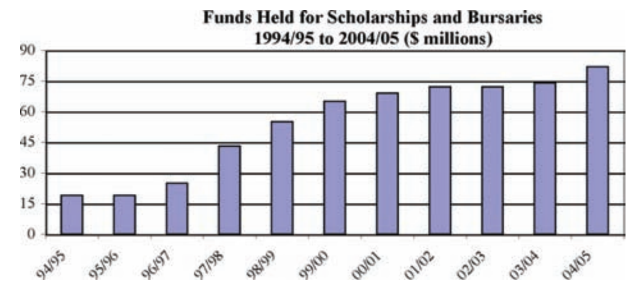
Total compensation expense of $368.5 million represents 58% of total expenses. The increase of 15% over 2003/04 is the result of a moderating increase in the number of faculty and staff, salary adjustments and accelerating costs of providing employee pension and other retirement benefits. A total of 6145 staff members were employed by McMaster University as at October 2004 (5,895 at October 2003), an increase of 4.2%, with 67% of these employees involved in direct academic and research activities and 33% providing administrative support.



Increasing compensation costs continue to put significant strain on financial resources. It is apparent that with costs escalating at a rate greater than revenue, measures will need to be developed and implemented to establish a long term sustainability strategy. In 2003/04 McMaster voluntarily resumed contributions to its salaried pension plan equivalent to 100% of employee contributions. Contributions to that plan have remained at 100% of employee contributions in 2004/05 and will increase to 200% of employee contributions in the 2005/06 year. McMaster is actively planning over the long term to ensure that increased future compensation costs are adequately identified in strategic and operational financial plans.

Student Financial Aid

Student aid (scholarships and bursaries) of $35.2 million (included in Supplies and Services) has increased by 2.3% over the previous year. McMaster is committed to assisting students in addressing the financial obligations associated with university study through increased bursary assistance.



To provide support for funding this growing need for financial assistance, McMaster has increased its endowments held for scholarships and bursaries from $74 million in 2003/04 to $82 million in 2004/05. Phase II of the Ontario Student Opportunity Trust Fund was introduced in 03/04 and subsequently replaced by the Ontario Trust for Student Support in May 2005. The new matching program will provide further donations and government matching funds for student financial aid.

Investment in Capital Assets

McMaster invested over $102 million in capital assets in 2004/05. Expenditures for completed building projects and construction in progress again accounted for almost half of this total. Another $38.5 million was spent on computers, furnishings, and other equipment and $7.3 million was spent on the acquisition of library materials.

Capital Asset Additions

	2004/05	2003/04
Completed Building Projects & Construction in Process	43,463	66,649
Computers, Furnishings and Other Equipment	38,486	40,386
McMaster Innovation Park	13,392	-
Library Materials	7,334	7,260
Nuclear Reactor Asset Retirement Obligation	213	-
	102,888	114,295

Funding Source for Additions in the year

	2004/05	2003/04
Externally Funded		
- Deferred Contributions for Capital Assets	40,036	56,073
Externally Funded		
- Debenture proceeds expended during the year	25,002	22,714
Provision for Decommissioning Nuclear Reactor	213	-
Internally Funded - Invested in Capital Assets (MIP)	13,392	-
Internally Funded - Invested in Capital Assets during Year	24,245	35,508
	102,888	114,295

Capital Planning and Management

McMaster's Campus Plan was approved by the Board of Governors in March 2002 and provides a comprehensive framework to guide capital development on campus. The plan is reviewed and revised annually to ensure that the University's physical infrastructure is an appropriate reflection of McMaster's academic excellence as new building and renovations occur. Under the plan, the University has embarked on extensive capital improvements designed to provide "state of the art" academic and research facilities necessary to support a leading-edge University. A significant number of the major buildings on campus have been renovated or expanded by projects which have being funded through a variety of government programs, such as Super Build, Canada Foundation for Innovation, as well as private donations and the proceeds of the $120 million, unsecured debenture issue in 2002. In 2004/05 the major building projects included Phase 1 of the Burke Science renovation, the completion of the Michael G. DeGroote Centre for Learning and Discovery, and the second phase of the 3 part Energy Reduction Project.

In 2004/05, the University purchased 37 acres of land in close proximity to the main campus for a cost of $13.4 million with a future plan to develop the McMaster Innovation Park (MIP). Contributions totaling $15 million from the province and the city will be used to develop a park that is vital to the growth and support of the research and development arms of a number of key industries. In July 2005, the federal government announced the relocation of its CANMET Material Technology Laboratory (MTL) to the park. Planning has begun and the building is expected to be completed in 3 years.

Strong Financial Position and Management of Business Risks

McMaster's total assets at April 30, 2005 are $1.4 billion compared to $1.3 billion at the previous year end, a growth of 6.7%. Liabilities and deferred contributions of $819.6 million are up by 5% over 2003/04 due primarily to an increase in deferred contributions of $14.1 million, and an increase in accrued employee future benefits of $15.4 million. Total long-term debt per FTE student decreased to $7,593 from $ 8,027 in 2003/04 reflecting McMaster's increasing ability to fund expansion through fund-raising and its own resources rather than through debt as well as an increase in FTE students. A sinking fund has been established to repay the $120 million of debentures in 2052.

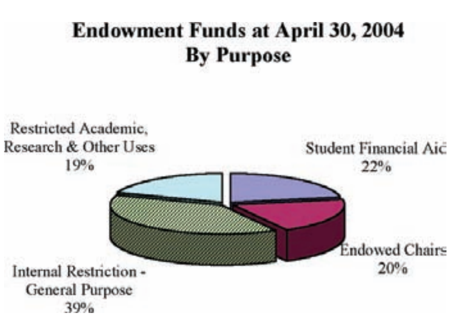
Net assets as of April 30, 2005 of $575.8 million increased by $51.6 million from the previous year due primarily to an increase in the amount invested in capital assets and the total of externally restricted endowments of $25.8 million and $45.8 million respectively.

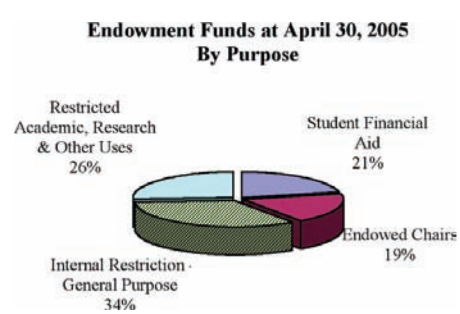
Endowments

Endowments are comprised of restricted donations received by the University and unrestricted donations that have been internally designated by the Board of Governors. The internally restricted component of McMaster's endowment had a market value of $131.5 million (2003/04 – $129.4 million) and the externally restricted component, including deferred contributions, had a market value of $254 million (2003/04 - $204.6 million). The market value of the University's total endowment of $385.5 million as at April 30, 2005, has grown by 15.6% over 2003/04. Endowment contributions of $52.8 million, and $21.4 million of investment income exceeded expenditures from endowment funds of $22.3 million.

McMaster's 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, 2005, of 7.08% (2003/04, 23.0 %), which is 0.35% lower than the policy benchmark for that period. Under the direction of the Finance Committee of the Board of Governors, the University regularly monitors the performance of its investment managers and during fiscal 2004/05, a change in the investment management of Non North American equities was made.

Investment returns on endowed funds support strategically important areas of expense, either by donor designation, or by internal Board of Governors designation. Funds held to support student scholarship and bursaries represent 21% of total internally and externally restricted endowments and funds held to support faculty salaries and research activities through the endowed chairs program represent 19% of the total endowment. Restricted Academic Research and other uses, has grown significantly from 19% to 26% mainly as a result of the DeGroote donations for medical research institutes and centres.





Employee Future Benefits

The funded status of the University's defined benefit pension plan, measured at April 30, 2005 is a deficit of $133.2 million. Post retirement and other post employment benefit plans report a deficit of $164.0 million. Recognizing the long-term nature of these liabilities, the University records the actuarially determined asset and liability values in its net asset position and the actuarially determined cost in its calculation of expenses. In these calculations, the University uses the corridor method to amortize any actuarial gains or losses, including changes resulting from adjustment of actuarial assumptions and investment experience gains and losses, over the average remaining service life of active employees. As a result, the amount included in the reserves of the University at April 30, 2005 in respect of the pension and other post retirement plans was $65.0 million as compared to $79.0 million at April 30, 2004.

The determination of the change in the funded status of the defined benefit pension plans maintained by the University from January 31, 2004 to April 30, 2005 (measurement date has been changed) and as disclosed in the 2004/05 audited financial statements follows:

Change in Funded Status of Pension Benefit Plans

From January 31, 2004 to April 30, 2005

	$ millions	
Funded status as at January 31, 2004		**(74.9)**
Costs incurred during the period:		
Employer share of current service cost	(24.4)	
Interest on liabilities	(50.7)	
Actual return on plan assets	78.9	3.8
Actuarial loss related to change in assumptions		(82.7)
Less: University contributions in the period		20.6
Funded status as at April 30, 2005		**(133.2)**

Changes in the assumptions include a reduction in the discount rate from 6.0% to 5.5% and a reduction in the expected long-term rate of return on plan assets from 7.5 to 7.0%. The April 30, 2005 pension liabilities also reflect the new Income Tax Act maximum defined benefit limits introduced in the 2005 Federal Budget.

Pension expense recorded in 2004/05 of $14.0 million is up by $12.6 million from 2003/04. The significant increase is mainly due to a reduction in the discount rate from 6.75% to 6.0% and the requirement to amortize $6.8 million of actuarial losses during the year. It is expected that the amortization of actuarial losses for 2005/06 will increase to approximately $13.7 million. In 2004/05, $5.7 million was added to pension reserves in net assets to fund future pension deficit amortization payments.

The University completed and submitted funding valuations for its Salaried Pension Plan and Hourly Pension Plan as at July 1, 2003 and July 1, 2004, respectively, and the next valuations are required on July 1, 2006 and July 1, 2007, respectively. Based on the July 2003 and July 1, 2004 valuations, the University has completed a funding plan that identifies a planned level of contributions, in excess of the regulatory minimum, that will be made prior to the next valuation. This funding plan minimises the short-term impact on the operating budget and allows for improved operational planning and phasing of the funding. In addition to development of a short term funding plan, the University has completed a review of investment strategies and is in the process of evaluating the plan design to assess appropriateness, effectiveness and alignment of the plan with its human resource goals. Once that review is complete, the long term funding plan will be finalized and approved.

The deficit status of the non-pension post retirement benefit plan as at April 30, 2005 of $164.0 million is $18.0 million greater deficit than as at January 31, 2004 (note change in measurement date). The significant changes are outlined in the chart below.

Change in Funded Status of Non-Pension Benefit Plans

From January 31, 2004 to April 30, 2005

	$ millions
Funded status as at January 31, 2004	**(145.9)**
Current service and interest costs	(14.8)
Change in discount rate from 6.25% to 6.00%	(6.6)
Other minor experience adjustments	(0.2)
Less: University cash payments in the period	3.5
Funded status as at April 30, 2005	**(164.0)**

Consistent with the actuarial best practice to complete a valuation every three years, a full actuarial valuation was completed in May 2004 and those results have been extrapolated to determine the April 30, 2005 accrued non-pension benefit obligation. Based on advice from the actuary, the assumptions used to project the cost of future health benefits was increased in 2003/04 and a more conservative mortality table was incorporated into the calculation of the obligation. There has been no change in these assumptions in 2004/05. The selection of the discount rate is based on high quality corporate bond yields, resulting in a reduction in the rate of 0.25%.

Non pension future employee benefit expense recorded in 2004/05 of $19.0 million is up by $8.9 million from 2003/04. The increase reflects higher current service and interest costs as well as the requirement to amortize $3.8m of previously unamortized actuarial losses. The University continues to fund post employment, non-pension benefits on a cash basis and has $4.0 million budgeted for this purpose in 2005/06. This amount is in line with estimates provided in the extrapolated results. Expected cost increases for future years, as projected by the actuaries, are being incorporated into in multi-year financial plans to ensure that funds are available to cover this increasing cost. As it does with all significant expenditures, the University is in the process of reviewing the design of current post retirement benefit plans to ensure value for money, cost effectiveness and cohesion with its human resource strategic goals and objectives.

Enterprise-Wide Risk Management

In November 2002, the University, under the leadership of the Audit Committee of the Board of Governors, initiated an enterprise-wide risk management program. Enterprise-wide risk management is defined as “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 as it creates value.” This program will serve as a key component of implementing Refining Directions.

The program involves four phases:

PHASE 1	PHASE 2	PHASE 3	PHASE 4
Assess Risks →	Establish Risk Management Process →	Design and Implement “Desired State” →	Evaluation and Improvement

The University now has:

- a comprehensive understanding of the risks facing the University
- a common risk language of risk terms and definitions
- an understanding of the gross risk assessment of each identified strategic risk
- an understanding of the relative prioritization of the identified risk
- an assessment of the current risk management effectiveness of each risk

The University has identified its twelve critical risks (not in any order of priority):

Critical Risks

Environmental Risks:	
Government Policy	the risk from changes in government policy or the failure to change policy when required
Competitor	the risk from the unanticipated actions of competitors, including other universities and new market entrants
Reputation	the risk resulting from the failure to establish or maintain McMaster’s reputation
Process Risks:	
Physical Infrastructure	the risk that the University will fail to establish or maintain the land, buildings and other physical assets (excluding technology) needed to meet the demands of students, faculty and staff
Student Satisfaction	the risk that the University does not focus on its students and does not address issues surrounding student satisfaction from an academic and non-academic standpoint

Critical Risks (Cont'd)

Process Risks (Cont'd):	
Partnering	the risk that third parties associated with the University through partnerships, alliances or other external relationships, do not act within intended limits of their authority or are not performing in a manner consistent with the University's goals
Leadership	the risk that the University's faculty and staff are not effectively lead, which may result in a lack of direction, focus, motivation to perform, credibility and trust
Change Readiness	the risk that employees within the University are unable to implement process and program/service improvements quickly enough to keep pace with changes in the marketplace
Financial	the risk that the University is unable to meet its financial commitments because funding levels are outpaced by the costs of operation or that resources are not effectively and efficiently deployed
Technology	the risk that the University does not maintain adequate systems and is not sufficiently leveraging advancements in technology.

As the University continues through each phase of the enterprise-wide risk management program, a risk owner has been identified for each risk. During 2004/05, a strategy was developed to ensure that each risk is addressed and managed at the organizational level. Risk templates have been prepared to quantify risk using a common rating scale, assess current risk management capabilities, define appropriate risk metrics and performance measures, and identify planned risk mitigation strategies. Some of these templates have been reviewed by the Audit Committee of the Board of Governors.

The attached statements present the financial position, operating results and cash flows of the University in accordance with CICA standards of financial reporting.

Consolidated Financial Statements
April 30, 2005

Table of Contents

McMaster University

Statement of Management Responsibility

The University is responsible for the preparation of the consolidated financial statements and has prepared them in accordance with Canadian generally accepted accounting principles for not-for-profit organizations. The consolidated financial statements present fairly the financial position of the University as at April 30, 2005 and the results of its operations and its cash flows for the year then ended.

In fulfilling its responsibilities and recognizing the limits inherent in all systems, the University has developed and maintains a system of internal control 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 consolidated financial statements.

The Board of Governors carries out its responsibility for review of the consolidated financial statements principally through its Audit Committee. Members of the Audit Committee are not officers or employees of the University. The Audit Committee meets with management and the external auditors to discuss the results of audit examinations and financial reporting matters. The external auditors have full access to the Audit Committee, with and without the presence of management.

The consolidated financial statements for the year ended April 30, 2005 have been reported on by KPMG LLP, the auditors appointed under the University Act. The Auditors' Report outlines the scope of their examination and provides their opinion on the fairness of presentation of the information in the consolidated financial statements.

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

KPMG LLP
Chartered Accountants
Box 976
21 King Street West Suite 700
Hamilton ON L8N 3R1

Telephone (905) 523-8200
Telefax (905) 523-2222
www.kpmg.ca

Auditors' Report

The Board of Governors
McMaster University

We have audited the statement of financial position of McMaster University as at April 30, 2005 and the statements of operations and changes in unrestricted net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the University as at April 30, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Hamilton, Canada
August 5, 2005

McMaster University

STATEMENT OF FINANCIAL POSITION
APRIL 30, 2005, WITH COMPARATIVE FIGURES FOR 2004
(in thousands of dollars)

	2005	2004
Assets		
Current Assets:		
Cash and cash equivalents	$ 114,405	$ 139,130
Research grants receivable	61,581	54,078
Accounts receivable	38,577	31,029
Government grants receivable	5,337	18,510
Inventories	6,312	6,169
Prepaid expenses	713	973
	226,925	249,889
Long-Term Assets:		
Investments (note 4)	477,143	415,858
Deferred pension asset (note 10)	175,890	175,990
	653,033	591,848
Capital Assets, net (note 5)	515,493	466,305
Total Assets	$ 1,395,451	$ 1,308,042

See accompanying notes to consolidated financial statements

	2005	2004
Liabilities, Deferred Contributions and Net Assets		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 55,527	$ 54,041
Unearned fees and other deferred revenue	20,688	16,030
Current portion of long-term debt (note 7)	828	778
	77,043	70,849
Deferred Contributions (note 6):		
Deferred contributions for future expenses	209,743	198,758
Deferred contributions for capital assets	284,159	281,022
	493,902	479,780
Long-term debt (notes 4 and 7)	157,146	157,974
Accrued employee future benefits (note 10)	86,617	71,131
Provision for decommissioning nuclear reactor (notes 3 and 13(c))	4,913	4,116
Net Assets (note 8):		
Unrestricted	13,985	10,028
Reserves	104,247	129,987
Invested in capital assets	121,443	95,619
Internally restricted endowments	131,515	129,465
Externally restricted endowments	204,640	159,093
	575,830	524,192
Total Liabilities, Deferred Contributions and Net Assets	$ 1,395,451	$ 1,308,042

See accompanying notes to consolidated financial statements

McMASTER UNIVERSITY
STATEMENT OF OPERATIONS AND CHANGES IN UNRESTRICTED NET ASSETS
FOR THE YEAR ENDED APRIL 30, 2005, WITH COMPARATIVE FIGURES FOR 2004
(in thousands of dollars)

	2005	2004
Revenues:		
Operating grants	$ 149,787	$ 139,594
Research overhead grants	13,212	12,690
Research grants and contracts	140,552	125,635
Tuition fees	111,246	106,979
Sales by ancillary operations	65,164	64,405
Donations and other grants	25,062	15,820
Investment income, net	36,106	56,554
Other revenue	59,158	51,313
Earned capital contributions	36,899	33,243
	637,186	606,233
Expenses:		
Salaries and wages	300,976	281,616
Employee benefits	67,552	38,367
Supplies and services	198,611	180,004
Amortization of capital assets	53,700	48,094
Interest on long-term debt	10,256	10,221
	631,095	558,302
Excess of revenues over expenses	6,091	47,931
Transfers/(uses of) excess of revenues over expenses:		
Increase in net assets invested in capital assets	(25,824)	(28,791)
Transfers to internally restricted endowments	(2,050)	(1,930)
Transfers from (to) reserves	25,740	(10,533)
	(2,134)	(41,254)
Increase in unrestricted net assets	3,957	6,677
Unrestricted net assets, beginning of year	10,028	3,351
Unrestricted net assets, end of year	$ 13,985	$ 10,028

See accompanying notes to consolidated financial statements.

McMASTER UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED APRIL 30, 2005, WITH COMPARATIVE FIGURES FOR 2004
(in thousands of dollars)

	2005	2004
Cash provided by (used in):		
Operating activities:		
Excess of revenues over expenses	$ 6,091	$ 47,931
Add (deduct) non-cash items:		
Decrease (increase) in deferred pension asset	100	(12,481)
Increase in accrued employee future benefits	15,486	6,827
Amortization of capital assets	53,700	48,094
Earned capital contributions	(36,899)	(33,243)
Net increase in deferred contributions restricted for future expenses	10,985	24,559
Increase in provision for decommissioning nuclear reactor	797	824
Net change in non-cash working capital (note 9)	4,383	(14,321)
Cash provided from operating activities	54,643	68,190
Financing and investing activities:		
Increase in deferred contributions restricted for capital assets	40,036	56,072
Contributions to externally restricted endowments	45,547	36,074
Repayment of long-term debt	(778)	(693)
Issue of long-term debt	-	1,617
Acquisition of capital assets	(102,888)	(114,295)
Net change in long-term investments	(61,285)	(103,874)
Cash used in financing and investing activities	(79,368)	(125,099)
Decrease in cash position	(24,725)	(56,909)
Cash and cash equivalents, beginning of year	139,130	196,039
Cash and cash equivalents, end of year	$ 114,405	$ 139,130
Supplementary information:		
Interest paid during year	$ 10,260	$ 10,107

See accompanying notes to consolidated financial statements.

Notes To Consolidated Financial Statements

FOR THE YEAR ENDED APRIL 30, 2005

1. AUTHORITY AND PURPOSE:
McMaster University operates by authority of The McMaster University Act, 1976. It is governed by a Board of Governors 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 a not-for-profit organization and is therefore exempt from income tax under Section 149 of the Income Tax Act.

These consolidated financial statements include the assets, liabilities, deferred contributions, net assets, revenues, expenses, and other transactions of the operations for which the University has jurisdiction. McMaster University controls McMaster University Trust Corporation (MUTC) and these consolidated financial statements consolidate the accounts of this corporation. MUTC is incorporated by letters patent as a corporation without share capital under the Ontario Corporations Act. MUTC holds the land acquired for the development of McMaster's Innovation Park.

These consolidated financial statements do not include the assets, liabilities and operations of McMaster Divinity College, McMaster Students Union Inc., McMaster University Student Centre, Incorporated and McMaster Children's Centre, Inc. which are independently governed and managed. Information on other related organizations is disclosed in Note 14 (Related Party Transactions).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:
The consolidated financial statements are prepared in accordance with the standards established by the Canadian Institute of Chartered Accountants for not-for-profit organizations.

The preparation of consolidated 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. Actual results could differ from those estimates.

(a) Accrual Accounting:

The University follows the accrual basis of accounting by recording income when earned and expenses when materials or services are received. Commitments for goods and services not yet received are not included in expenses.

Pledges from fund raising and other donations, because of the uncertainty of receipt, are not recorded until the year of receipt of cash or other assets.

(b) Revenue Recognition:

Operating grants are recognized as revenue in the period received or receivable. Operating grants relating to a future period are recorded as deferred contributions and recognized as income in the periods to which they relate.

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

Grants for sponsored research are recorded as deferred contributions. When research expenditures funded by such grants are incurred during the year, the equivalent amounts are brought into revenue.

Grants and donations received for the acquisition of capital assets are recorded as deferred contributions until such time as they are invested in capital assets. When invested in capital assets, the amounts are transferred to deferred contributions for capital assets and recognized as earned capital contributions revenue in the periods in which the amortization of the related capital assets is recorded.

Endowment donations are recognized as a direct increase in net assets held as endowments. Income earned from the investment of endowments principal, to the extent it is restricted, is recorded as deferred contributions and recorded as revenue in the periods in which the related expenses are incurred.

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

(b) Revenue Recognition (continued):

To ensure the University is able to protect the capital value of endowment investments, the 'preservation of capital' policy was implemented during 2005. This policy limits the amount of income made available for spending and requires the reinvestment of excess income, based on the projected long term rate of return on investments. In future years, should investment returns be insufficient to fund the amount made available for spending, amounts will be transferred from the accumulated net investment income. For individual endowment funds without sufficient accumulated excess investment income, temporary encroachment on endowed capital is permitted to support the desired level of spending. The amount is expected to be recovered by future net investment income.

Other externally-restricted contributions are recorded as deferred contributions and recognized as revenue in the periods in which the related expenses are incurred.

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

(c) Investments:

Investments with a term to maturity of 90 days or less at date of acquisition are included with cash and cash equivalents and are recorded at cost plus accrued income. Long-term investments are carried at estimated fair values, generally evidenced by the quoted market value. The estimated fair values are based upon market conditions at a specific point in time and may not reflect future fair values. Changes in fair values are included in investment income. Externally restricted investment income 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 related to internally restricted endowments is recorded as revenue during the period in which it is earned and is transferred from unrestricted net assets to internally restricted endowments.

(d) Inventories:

Inventories are stated at the lower of cost and net realizable value.

(e) Prepaid Expenses:

Expenditures incurred for materials and services to be consumed in future periods are recorded as prepaid expenses and recorded as expenses in the year consumed.

(f) Capital Assets:

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

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Asset	Rate
Land	-
Buildings	2.5% to 10%
Nuclear reactor asset retirement obligation	4%
Site improvements	5%
Library materials	10%
Computing systems	10%
Equipment, furnishings and vehicles	20%
Computing equipment	33.3%

(g) Works of Art:

Works of art are expensed in the year of acquisition. During the year, $22,000 (2004 - $69,000) of works were purchased or donated.

(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 consolidated financial statements.

(i) Ancillary Enterprises:

Charges are made to ancillary enterprises for all costs associated with these operations including replacements and renovations of equipment and facilities. The enterprises are self-sustaining and are intended to operate on a breakeven basis.

Any profits/losses from ancillary operations are added to/deducted from reserves.

(j) Employee Future Benefits:

The University maintains defined-benefit plans providing pension, other retirement, and post-employment benefits for substantially all full-time employees.

Registered pension plan assets are valued at a market related value (smoothed for the difference between actual and expected investment income over five years) for purposes of calculating expected return on plan assets. The other pension and other post retirement and post employment benefit plans are unfunded. The costs of pension and other post-employment benefits (primarily medical benefits and dental care) related to the employees' current service is charged to income annually. The current service cost and the accrued benefit obligation is computed separately for each plan, on an actuarial basis using the projected benefit method prorated on service and management's best estimates of investment yields, salary escalation, health care trend rates and other factors. The University has elected to use the

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

(j) Employee Future Benefits (continued):

corridor method to amortize actuarial gains or losses (such as changes in actuarial assumptions and experience gains or losses) over the average remaining service life of active employees. Under the corridor 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.

(k) Reserves:

The Board of Governors has approved a policy of permitting departments to carry forward unexpended budgets into the subsequent fiscal year for expenditure in that year. In addition, the University reserves other portions of fund balances for specific purposes approved by the Board of Governors.

(l) Financial Instruments:

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

3. CHANGE IN ACCOUNTING POLICY:

During the year, the University changed its accounting policy for asset retirement obligations. Previously, such obligations were recognized as incurred. Under the new policy, asset retirement obligations are recognized in the period in which they are incurred, if a reasonable estimate of a fair value can be determined. The associated asset retirement costs are capitalized as a part of the carrying amount of the asset. The liability is accreted over the estimated time period until settlement of the obligation and the asset is amortized over the remaining useful life of the asset. This change has been applied effective April 30, 2005.

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

4. INVESTMENTS:

(in thousands of dollars)	2005		2004	
	Market	Cost	Market	Cost
Equities:				
Canadian	$ 88,327	$ 70,282	$ 77,110	$ 65,414
United States	83,049	91,886	78,170	90,306
Non-North American	84,792	79,543	82,966	93,048
	256,168	241,711	238,246	248,768
Fixed income	219,606	213,475	175,784	172,616
Other	1,369	1,389	1,828	1,847
Total	$ 477,143	$ 456,575	$ 415,858	$ 423,231

Included in investments are the following accounts at market value held for restricted purposes:

	2005	2004
Restricted for debt repayment sinking funds:		
Student residence mortgage due 2011 (note 7(a))	$ 3,809	$ 3,883
Debentures due 2052 (note 7(d))	8,275	7,684
Restricted for provision for decommissioning of nuclear reactor (note 13(c))	4,700	4,116
	$ 16,784	$ 15,683

5. CAPITAL ASSETS:

Capital assets consist of the following:

(in thousands of dollars)	Cost	Accumulated Amortization	2005 Net	2004 Net
Land	$ 16,099	$ -	$ 16,099	$ 2,707
Buildings	513,216	176,062	337,154	230,099
Site improvements	6,412	4,961	1,451	1,116
Library materials	103,621	70,374	33,247	31,968
Equipment, furnishings and vehicles	235,067	158,281	76,786	75,092
Computing systems and equipment	91,212	74,869	16,343	14,846
Construction in progress	34,200	-	34,200	110,477
Nuclear reactor asset retirement obligation	213	-	213	-
	$ 1,000,040	$ 484,547	$ 515,493	$ 466,305

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

6. DEFERRED CONTRIBUTIONS AND DEFERRED CAPITAL CONTRIBUTIONS:

Deferred contributions represent unexpended amounts, which are subject to externally imposed restrictions. Deferred capital contributions represent the unamortized amounts of grants and donations used for the purchase of capital assets. Changes during the year are as follows:

(in thousands of dollars)	Deferred Contributions	Deferred Capital Contributions
Balance, beginning of year	$ 198,758	$ 281,022
Contributions received and receivable:		
Research grants and contracts	160,711	–
Donations and other grants	63,864	–
Investment income	15,434	–
Transferred to revenue:		
Operating grants	(1,435)	–
Research grants and contracts	(140,552)	–
Donations and other grants	(26,336)	–
Investment income	(15,434)	–
Amortization of capital assets acquired with capital grants and donations	–	(36,899)
Transferred to acquire capital assets	(40,036)	40,036
Transferred to externally restricted endowments	(5,231)	–
Balance, end of year	$ 209,743	$ 284,159

Deferred contributions consist of the following:

(in thousands of dollars)	2005	2004
Research grants and contracts	$ 137,407	$ 141,298
Donations, other grants and investment income	48,976	45,485
Capital grants and donations	23,360	10,540
Other restricted funds	–	1,435
	$ 209,743	$ 198,758

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

7. LONG-TERM DEBT:

Long-term debt consists of the following:

(in thousands of dollars)	Maturity Year	Interest Rate	2005 Principal Outstanding	2004 Principal Outstanding
Student residence mortgage	2011	9.81%	$ 11,544	$ 11,544
Bank loan	2012	6.25%	4,505	4,949
Mortgage	2016	5.38%	1,268	1,346
Bank loan	2033	6.63%	20,657	20,913
Debentures	2052	6.15%	120,000	120,000
			157,974	158,752
Principal due within one year			(828)	(778)
			$ 157,146	$ 157,974

Principal due in each of the following five years are as follows:

2006	$ 828
2007	881
2008	937
2009	997
2010	1,060

(a) An internal sinking fund has been established to provide funds to repay a portion of the principal of the student residence mortgage upon maturity in 2011. The purchase of sinking fund investments is financed by a charge to the residence ancillary operation. No additional sinking fund investments were purchased in 2005. The value of the sinking fund is $4,173,000 (2004 - $3,883,000) and is included in cash and investments at April 30, 2005.

(b) The unsecured bank loan matures December 1, 2012 bearing interest at 6.25% under a 10-year interest rate swap agreement.

7. LONG-TERM DEBT (continued):

(c) During 2004, the original bridge financing was converted to take out financing for the new student residence. The long-term financing is in the form of a 30-year amortization, 10-year floating rate unsecured term loan. The University has entered into an interest rate swap agreement with the bank whereby an interest rate of 6.63% has been fixed for 30 years.

(d) On October 7, 2002, the University issued senior unsecured debentures in the aggregate principal amount of $120,000,000 at a price of $999.07 for proceeds of $119,888,400. The debentures bear interest at 6.15% payable semi-annually on April 7 and October 7 with the principal payable on October 7, 2052. The proceeds of the issue are being used to finance capital projects including the University Student Centre, the Michael DeGroote Centre for Learning and Discovery and various other academic and research buildings. The issue price discount and other debt issue costs were expensed during 2003. An internal sinking fund has been established to provide funds to repay the debenture principal upon maturity in 2052. An initial amount of $6,140,000 was transferred from internally restricted endowments in 2003 to create the sinking fund. Subsequent increases to the sinking fund are charged to operations. The value of the sinking fund is $8,275,000 (2004 - $7,684,000) and is included in investments at April 30, 2005.

(e) To finance the new student residence, an interest rate swap strategy was adopted to lock in interest rates to match expected cash flows from residence fees. The fair value of interest rate swap agreements was based on amounts quoted by the University's bank to realize favourable contracts or settle unfavourable contracts, taking into account interest rates at April 30, 2005. At April 30, 2005, the interest rate swap agreements were in a net unfavourable position, representing an unrecognized liability of $4,167,000 (2004 - $2,879,000).

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

8. NET ASSETS:

Net assets are classified as follows:

a) Unrestricted Net Assets: General funds available for future operations or, if negative, cumulative operating deficit.
b) Reserves: Funds allocated for specific purposes and unexpended budgets carried forward for future expenditures within budget units.
c) Invested in Capital Assets: Internally generated funds invested in capital assets, exclusive of capital assets financed through long-term debt or capital contributions.
d) Internally Restricted Endowments: Unrestricted donations, bequests and other funds, which have been endowed by action of the Board of Governors, including unspent investment income.
e) Externally Restricted Endowments: Non-expendable donations and bequests. Unspent investment income is shown as deferred contributions for future expenses.

Changes in net assets for the year are:

	2005						2004
(in thousands of dollars)	Unrestricted	Reserves	Invested in Capital Assets	Internally Restricted Endowments	Externally Restricted Endowments	Total	Total
Balance, beginning of year	$ 10,028	$ 129,987	$ 95,619	$ 129,465	$ 159,093	$ 524,192	$ 440,187
Excess of revenues over expenses	(19,733)	–	25,824	–	–	6,091	47,931
Internal restrictions:							
Transfers (to) from reserves	25,740	(25,740)	–	–	–	–	–
Transfers (to) from internally restricted endowments	(2,050)	–	–	2,050	–	–	–
Contributions to externally restricted endowments	–	–	–	–	45,547	45,547	36,074
Balance, end of year	$ 13,985	$ 104,247	$ 121,443	$ 131,515	$ 204,640	$ 575,830	$ 524,192

8. NET ASSETS (continued):

Reserves consist of the following:

(in thousands of dollars)	2005	2004
Employee benefits:		
Pensions	$ 144,335	$ 143,356
Other Post-Employment and Post-Retirement Benefits	(79,293)	(64,332)
	65,042	79,024
Unexpended departmental budgets	43,098	41,156
McMaster Innovation Park	(13,392)	–
Other specific purposes	9,499	9,807
	$ 104,247	$ 129,987

9. NET CHANGE IN NON-CASH WORKING CAPITAL:

The net change in non-cash working capital consists of the following:

(in thousands of dollars)	2005	2004
Research grants receivable	$ (7,503)	$ 3,520
Accounts receivable	(7,548)	(4,096)
Government grants receivable	13,173	(18,372)
Inventories	(143)	(138)
Prepaid expenses	260	(221)
Accounts payable and accrued liabilities	1,486	5,487
Unearned fees and other deferred revenue	4,658	(501)
	$ 4,383	$ (14,321)

10. EMPLOYEE FUTURE BENEFITS:

The University maintains defined benefit plans providing pension and other retirement and post-employment benefits including extended health care and dental to substantially all full-time employees.

The accrued benefit obligations as determined by independent actuaries and the fair values of the plan assets are as at April 30, 2005, the measurement date for 2005 and January 31, 2004, the measurement date for 2004.

In 2005, the actuarially determined expense/ (income) recognized for the University's benefit plans is as follows:

	2005		2004	
(in thousands of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Net benefit costs incurred	$ 13,994	$ 18,992	$ 1,366	$ 10,072

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

10. EMPLOYEE FUTURE BENEFITS (continued):

Information about the University's defined benefit plans as at April 30, in aggregate, is as follows:

	2005		2004	
(in thousands of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligation	$ 1,014,467	$ 164,015	$ 895,746	$ 145,879
Fair value of plan assets	881,288	–	820,841	–
Funded status – plan deficit at April 30 (January 31 for 2004)	(133,179)	(164,015)	(74,905)	(145,879)
Reconciliation to deferred benefit asset/(liability) at April 30:				
Measurement date adjustment	–	–	6,793	–
Unamortized past service cost	164	–	180	–
Unamortized actuarial loss	308,905	77,398	243,922	74,748
Deferred pension asset (Accrued employee future benefits) at April 30	$ 175,890	$ (86,617)	$ 175,990	$ (71,131)

Each of the plans included above has accrued benefit obligations in excess of the fair value of plan assets at the measurement date.

Included in the above accrued benefit obligation and fair value of plan assets are the following amounts in respect of plans that are not fully funded:

	2005		2004	
(in thousands of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligation	$ 65,756	$ 164,015	$ 64,272	$ 145,879
Fair value of plan assets	–	–	–	–
Funded status – plan deficit	$ (65,756)	$ (164,015)	$ (64,272)	$ (145,879)

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

10. EMPLOYEE FUTURE BENEFITS (continued):

Information about the plan assets for the pension benefit plans as at April 30, 2005 includes the following:

	Percentage of fair value of total plan	Target allocation percentage	Expected long-term rate of return
Equity securities	62%	65%	8.6%
Debt securities	36%	35%	4.8%
Other	2%	0%	3.0%

The significant actuarial assumptions adopted in measuring the University's accrued benefit obligations at April 30, 2005 are as follows:

	Pension Benefit Plans	Other Benefit Plans
Discount rate	5.5%	6.0%
Expected long-term rate of return on plan assets	7.0%	-
Rate of compensation increase	4.5%	4.5%

The significant actuarial assumptions adopted in measuring the University's actuarially determined income/(expense) recognized in the year are as follows:

	Pension Benefit Plans	Other Benefit Plans
Discount rate	6.0%	6.25%
Expected long-term rate of return on plan assets	7.5%	-
Rate of compensation increase	4.5%	4.5%

10. EMPLOYEE FUTURE BENEFITS (continued):

For measurement purposes, a 10% annual rate of increase on the 2003 per capita cost of medical benefits was assumed. The rate was assumed to decrease to 5% by 2009, and remain at that level thereafter. A 5% annual rate of increase is assumed for dental benefits.

	2005		2004	
(in thousands of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Employer contribution	$ 13,896	$ 3,506	$ 13,155	$ 3,245
Employee contribution	8,168	–	7,105	–
Benefits paid	40,162	3,506	42,861	3,245

The most recent actuarial valuation for the pension benefit plans for funding purposes for hourly-rated employees was completed and filed as at July 2004. The next required valuation will be filed as at July 1, 2007. The most recent actuarial valuation for the pension benefit plans for funding purposes for all other employees was completed as at July 2003 and the next required valuation will be filed as at July 1, 2006. The most recent valuation for financial statement purposes for other benefit plans was completed by an independent actuary as at May 1, 2004. The results of each of these valuations have been extrapolated to April 30, 2005 which is the measurement date used to determine the accrued benefit obligation for all post-retirement benefit plans.

11. PLEDGES RECEIVABLE:

Outstanding pledges expected to be received in future years, not included in revenue and accounts receivable, are $71,673,000 (2004 - $72,864,000).

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

12. ONTARIO STUDENT OPPORTUNITY TRUST FUND:

Externally restricted endowments include grants provided by the Government of Ontario from the Ontario Student Opportunity Trust Fund matching program to award student aid as a result of raising an equal amount of endowed donations.

(a) ONTARIO STUDENT OPPORTUNITY TRUST FUND – Phase I

The following schedule represents the changes for the year ended April 30, 2005 and 2004 in the first phase of the Ontario Student Opportunity Trust Fund balance:

(in thousands of dollars)	2005	2004
Endowment balance, beginning of year	$ 31,297	$ 29,617
Investment income (provided from) preservation of capital	1,728	1,727
Investment income transferred to expendable income	(1,355)	(47)
Balance, end of year	31,670	31,297
Funds available for awards, beginning of year	–	–
Investment income	(208)	1,527
Bursaries awarded (2005: 683 awards; 2004: 1185 awards)	(1,147)	(1,574)
Investment income transferred from preservation of capital	1,355	47
Funds available for awards, end of year	–	–
Total funds at book value	$ 31,670	$ 31,297

The market value of the endowment as at April 30, 2005 was $30,312.

(b) ONTARIO STUDENT OPPORTUNITY TRUST FUND – Phase II

The Ontario government requires separate reporting of balances as at March 31 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 of McMaster University including Divinity College.

The following is the schedule of donations received for the year ended March 31, 2005 and March 31, 2004:

(in thousands of dollars)	2005	2004
Eligible for matching	$ 2,092	$ 692
Unmatched cash donations	104	907
Outstanding pledges received	3,020	421
Cash and pledge total	$ 5,216	$ 2,020

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

12. ONTARIO STUDENT OPPORTUNITY TRUST FUND (continued):
(b) ONTARIO STUDENT OPPORTUNITY TRUST FUND – Phase II (continued)

Certain cash donations received are eligible for matching by the Ministry of Training, Colleges and Universities ("MTCU"). The following is the schedule of changes in the endowment balance for the year ended March 31, 2005 and March 31, 2004:

(in thousands of dollars)	2005	2004
Balance, beginning of year	$ 2,291	$ –
Cash donations received within annual matching ceiling	2,092	692
Funds received from MTCU	2,092	539
Funds receivable from MTCU	–	153
Unmatched cash donations	104	907
Fund balance, end of year	$ 6,579	$ 2,291

The following is the schedule of changes in the expendable funds for awards for the year ended March 31, 2005 and March 31, 2004:

(in thousands of dollars)	2005	2004
Balance, beginning of year	$ 39	$ –
Investment income for expenditures	96	49
Bursaries awarded (2005: 34; 2004: 8)	(53)	(10)
Balance, end of year	$ 82	$ 39

13. COMMITMENTS AND CONTINGENT LIABILITIES:

(a) Canadian Universities Reciprocal Insurance Exchange:

The University is a member of the Canadian Universities Reciprocal Insurance Exchange (CURIE), a self-insurance co-operative 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) Outstanding Legal Issues:

The University is involved from time to time in litigation which arises in the normal course of operations. With respect to claims outstanding at April 30, 2005, the University believes it has valid defenses and appropriate insurance coverage in place. In the event that any claims are successful, the settlements of such claims are not expected to have a material effect on the financial position of the University.

McMASTER UNIVERSITY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED APRIL 30, 2005

13. COMMITMENTS AND CONTINGENT LIABILITIES (continued):

(b) Outstanding Legal Issues (continued):

During 2001, a legal claim was served on the University alleging that the University breached various duties in failing to remunerate a former employee with respect to patents that have been filed. Pursuant to a settlement agreement, an amount was included in accounts payable at April 30, 2004 and paid during 2005 in full settlement of the claim.

(c) McMaster Nuclear Reactor:

It is expected that at some undeterminable future date the McMaster Nuclear Reactor will be decommissioned. Under an agreement with the Canadian Nuclear Safety Commission (CNSC), a trust fund has been set up. An amount is being contributed annually to provide for these costs. As at April 30, 2005, the value of the trust fund is $4,700,000. The related investments restricted by the Board of Governors exclusively for this purpose are included in long-term investments. In total, the net present value of the estimated costs for decommissioning, at April 30, 2005, is $4,913,000 using a risk free rate of 5.10%.

(d) Capital Commitments:

The estimated cost to complete approved major capital projects is $104,000,000 at April 30, 2005. These costs will be financed by unexpended departmental budget reserves, government grants, fundraising, student contributions, bank financing, the proceeds of the $120,000,000 debenture issue and future ancillary operations revenue streams.

(e) Other Commitments:

The annual payments under various operating leases are approximately $3 million.

14. RELATED PARTY TRANSACTIONS:

Certain fundraising activities are carried out by the following related organizations: The McMaster University Trust, The McMaster University Foundation, and Friends of McMaster Incorporated. The assets and liabilities and operations of these organizations have not been consolidated with and are not material to these consolidated financial statements. Funds donated by these organizations to McMaster University during the year were $43,000 (2004 - $249,000).

15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.

McMaster University

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