McMaster University

McMaster University Annual Financial Report ■ 2007/08

Measuring our performance

Measuring our Performance

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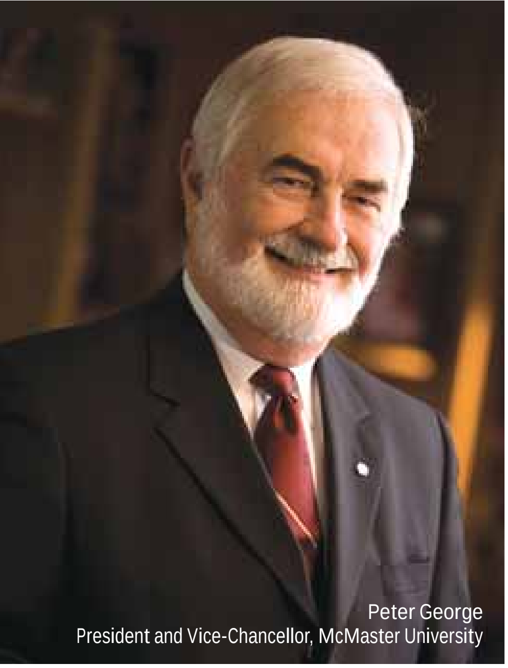
1 This commentary includes future-oriented financial information and commentary ("FOFI") which may involve, but are not limited to, comments with respect to the University's future objectives, strategies, targets or results. Readers are cautioned as to undue reliance on the FOFI as a number of factors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



Peter George
President and Vice-Chancellor, McMaster University

Measuring our Performance – 2007/08

Executive Summary

McMaster University is one of Canada's leading student centred, research intensive institutions. This reputation is recognized internationally. The institutional leadership in innovation extends to the annual planning process and is evident in the focus placed on planning and prioritization of strategic initiatives and in the resource allocation to support these priorities.

The 2007/08 financial results are an indicator of the significant financial challenges facing the University:

SUCCESSES AND CHALLENGES

SUCCESSES

- surpassed enrolment targets and increased entering average
- completed the first year of the three year plan to eliminate the operating deficit
- ranked 2nd in Canada for research intensity
- appointed 30 of the new 'teaching-stream' faculty positions as of July 1, 2008

CHALLENGES

- unfunded post retirement and post employment obligations for pension and other benefit liabilities such as dental and drug plans
- increased inflationary costs outpace new revenues
- increased provincial funding uncertainty
- reduced operating net assets available to re-invest

The successes of the past year include expansion of teaching and research programs, growth in the number of international and out of province student applications and an increased level of fundraising success. McMaster's financial performance continues to be challenged by limits to our control over revenues and fee setting autonomy. 2007/08 was particularly difficult due to the loss of investment income, which required the University to use earnings previously preserved under its endowment policy to support trust fund and operating expenditures. Led by salary and benefit costs, expenses continued to grow faster than revenue necessitating budget reduction strategies to be implemented. While external debt did not increase, borrowing against internal reserves was required to fund capital projects.

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

Peter George

The review performed by the credit rating agencies this past year resulted in the maintaining of an AA rating, however DBRS changed its trend from Stable to Negative based on the declining operating results, indication for increased debt and rising post retirement benefit costs. The University has enhanced monitoring of each of these areas through the adoption of policies, such as in the Debt Management Policy; development of prioritization strategies and implementation of task groups to develop alternative approaches that balance fiscal prudence with maintaining the quality of the institution.

McMaster continues to meet its enrolment targets, and student quality continues to rise. However the financial indicators show signs of weakness.

HIGHLIGHTS AT A GLANCE	2007/08	2006/07	%inc/(decr)
Enrolment (Full Time Equivalent (FTE))	23,501	22,903	2.6%
% of level 1 students with an entering grade > 80%	77.5%	73.7%	5.2%
Total Net Assets ($ millions)	672.1	693.3	(3.1%)
Operating Net Assets ($ millions)	57.6	86	(33%)
Endowment per FTE student ($)	20,900	21,800	(4.1%)
Total Revenue per FTE student ($)	31,200	31,900	(2.2%)
Excess (Deficiency) of Revenues over Expenses ($ millions)	(13.5)	23.7	(157%)
Excess of Revenues over Expenditures – Operating Fund only ($ millions)	9.9	8.6	15.1%

The Excess of Revenues over Expenditures in the Operating Fund was $9.9 million. While this surplus is evidence of significant planning and fiscal diligence, it does not take into account the rising cost of post employment benefits, nor the payment required to fund the salaried pension plan deficit. The positive operating fund position was made possible by the decision of the Board of Governors to fund special pension deficit payments and the faculty retirement incentive plan from internally restricted endowments and to defer the accrued cost of health and dental post retirement benefits to future periods. These difficult decisions to utilize the University's balance sheet strength in order to address short-term financial needs were necessary to preserve academic quality today.

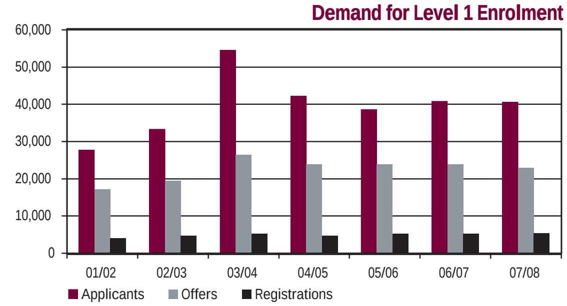
There continues to be difficult decisions to be made in order to balance short-term operational needs with the long term financial strength of the University. Over the past year a number of task forces were established to support the implementation of the Refining Directions strategic plan that will provide advice to inform these decisions. The University must continue to focus attention on revenue generation, control of rising benefit costs and strategic deployment of resources to support the mission and vision of the institution.

2007/08 Key Financial Indicators

Achieve Strong Demand for Programs

- the proportion of students naming McMaster as their first choice remained constant
- the percentage of students who accepted McMaster offers increased slightly at 23.4% (2006/07-22.1%)
- 0.6% decrease in Level 1 applications

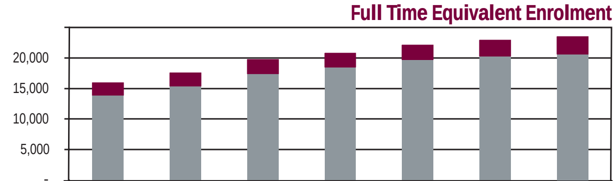
Demand for Level 1 Enrolment



Achieve Targeted Enrolment Levels

- 2.6% annual increase in total full time equivalent (FTE) enrolment (598 additional FTE's)
- FTE enrolment was ahead of target by 3.3%
- 1.6% growth in undergraduate enrolment, and an 10.1% increase in graduate enrolment

Full Time Equivalent Enrolment

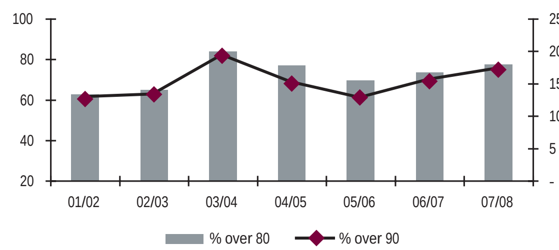


	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Graduate	2,035	2,185	2,389	2,344	2,439	2,634	2,901
Undergraduate	13,895	15,406	17,388	18,463	19,702	20,269	20,600

Attract Students with High Academic Standing

- average entering grade increased to 84.1% (2006/07-83.5%) as calculated on best 6 required courses
- % of Level 1 students with an entering average greater than 80, increased to 77.5% (2006/07-73.7%)
- % of Level 1 students with an entering average greater than 90% increased to 17.2% (2006/07-15.5%)

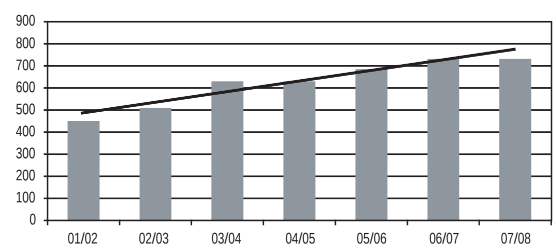
Student Quality
% of Level 1 Students by Entering Grade



Increase the Revenue Base

- marginal increase of $1.023 million (0.14%) in total revenue reflects increased tuition income offset by a reduction in operating grants and investment income
- revenue has grown by 43.5% over the past five years to $732 million
- revenue per FTE at $31,200 declined slightly from 2006/07 ($31,900)

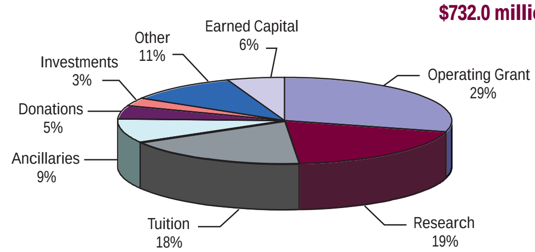
Total Revenue
$ millions



Diversify the Revenue Base

- well-diversified revenue base reduces dependency on any one source
- % of revenue received from operating grants decreased due to significant one-time year end grants from the Ministry of Training, Colleges and Universities (MTCU) received in 2006/07

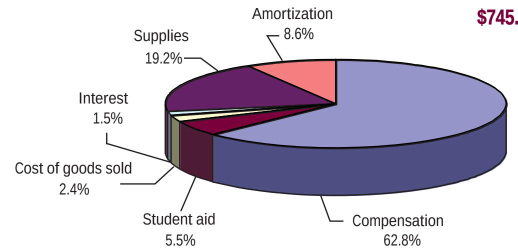
2007/08 Total Revenue
$732.0 million



Strategic Deployment of Resources

- expenses increased by $38.2 million (5.4%), as a result of growth in enrolment and compensation costs
- compensation expense increased by 7.3% resulting from increases in number of staff (1.8%), wage rates and employee benefit costs
- the proportion of expenses spent on student financial aid remain constant

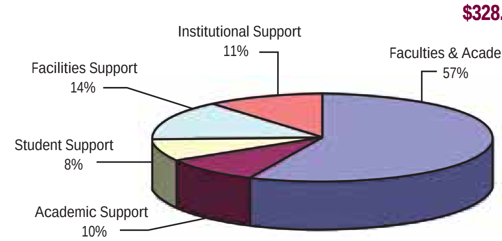
2007/08 Total Expenses
$745.5 million



Strategic Deployment of Resources

- 57% of operating expense is invested into Faculty, Academic Priority and Academic Support budget envelopes (2006/07-54%)
- the proportion of operating expenditures for facilities support declined from the 2006/07 high of 17% back to the more typical 14%

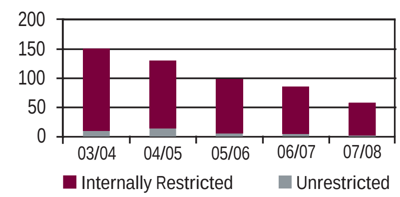
2007/08 Operating Fund Net Expenditures by Envelope
$328.8 million



Strengthen Financial Position – used to support operations

- $28.4 million decrease of total operating net assets
- internally restricted net assets decreased by $25.3 million:
  - change in employee future benefit reserves of $23.2 million, and internal loans of $16.3 million
  - increase in specific purpose reserves related to a $9.9 million increase in departmental reserves

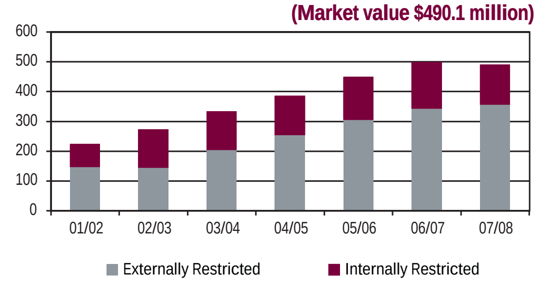
Operating Net Assets
$ millions



Strengthen Financial Position – endowment funds

- endowment per FTE student of $20,900 decreased due to drawdown of internal endowment for faculty retirement and special pension contributions
- external endowments (including deferred donations) increased 3.8% ($13.2 million)
- decreased net investment return of (0.1)% on long term investment pool (2006/07-11%)

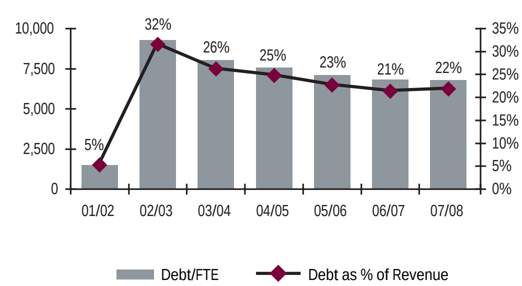
Growth in Endowment Funds
(Market value $490.1 million)



Manage Business Risks – long term debt

- long term debt of $159.7 million increased marginally
- long term debt per student at $6,795 decreased (2006/07- $6,823)
- a total of $49.1 million ($2,089 per FTE) of capital project debt was financed internally (2006/07-$32.8 million)
- voluntary sinking funds amounted to $15.2 million of which $10.4 million is available to repay the $120 million debenture principal in 2052

Long Term Debt Ratios



Mission, Vision and Strategy

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

Mission

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

Vision

To achieve international distinction for creativity, innovation and excellence.

Strategy – Refining Directions

The *Refining Directions* strategic planning exercise was launched in 2002 with two objectives: to evaluate the University's success in meeting the goals established in the 1995 Directions Strategic plan; and to construct a strategic framework to guide the University's course for the next decade.

Over the course of this past academic year, a number of new committees and task forces were established to support the implementation of *Refining Directions*.

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

Financial Management

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

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

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

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

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

Continuing to balance the operating fund budget remains a challenge and a top priority. The 2008/09 budget was recently approved by the Board of Governors as the second year of the three year financial plan that is on track to achieve its 2009/10 objective of eliminating the in-year operating fund deficit. While this plan respects the fiscal operating challenges and invests in strategies that further the achievement of the *Refining Directions* goals, it does not address the accrued cost of pension and non-pension post retirement benefits.

Key Financial Indicator 1 – Achieve Strong Demand for Programs

In 2007/08, the University achieved its goal of increasing demand for its programs and meeting student enrolment targets. McMaster's culture of innovation in linking teaching and scholarship and its reputation for problem based learning and inquiry-based programs continues to be a strong attraction for academically high achieving students.

The slight decrease in the number of applications to McMaster programs (0.6% less than 2006/07) reflected increased applications from other provinces offset by a small decrease in part time applicants and those applying directly from the Ontario Universities Applications Centre. The proportion of applicants who named McMaster as their first choice remained at last year's rate despite higher published cut-off entering grades for many programs. Both are an indication of the continuing strong demand for McMaster programs. The percentage of students who accepted McMaster offers increased from 22.1% (2006/07) to 23.4%.

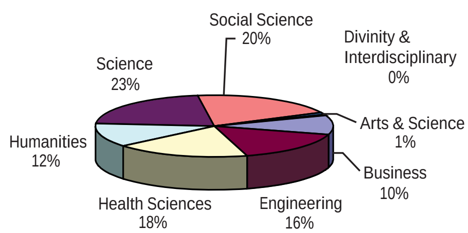
Full time equivalent[1] (FTE) enrolment in 2007/08 increased by 2.6% over the previous year and 3.3% over the target for the year, reflecting the alignment of Provincial government initiatives with McMaster's 2007/08 commitment to provide access to post-secondary education to a growing number of qualified students. The increase in FTE enrolment was made up of a 1.6% increase in undergraduate enrolment and a 10.1% increase in graduate enrolment. Increased graduate student enrolment is a key component of the *Refining Directions* strategic plan and is consistent with the Ontario government's *Reaching Higher, A plan for Post-secondary Education strategy.*

The University has achieved its FTE enrolment target while maintaining its commitment to enhancing the entering average of the Level 1 class. In 2007/08, McMaster achieved the following improvements in student quality:

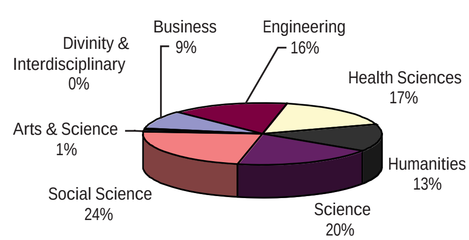
- The overall entry grade for students coming directly from Ontario secondary schools increased to 84.1% (2006/07-83.5%) as calculated on the best six required courses.
- McMaster's percentage of Level 1 students with an entering average of greater than 80% increased from 73.7% in 2006/07 to 77.5% in 2007/08.
- The percentage of Level 1 students entering with an average grade over 90% increased from 15.5% in 2006/07 to 17.2% in 2007/08.

Student enrolment in 2007/08 continues to be well distributed through the University's six Faculties. Note that, in 2007/08 the Faculties of Science and Social Science reflect a 3% increase and 3% decrease respectively as the Kinesiology department moved from the Faculty of Social Science into the Faculty of Science in a strategic reorganization.

2007/08 FTE Enrolment
23,501 FTEs
NB. Kiniesology students now in Science



2006/07 FTE Enrolment
22,903 FTEs



■ Looking forward to 2008/09, preliminary enrolment numbers indicate an increase over 2007/08 and over targeted levels. The Provincial commitment to adequately fund the 2008/09 increases in enrolment is unclear. Accepting inadequately funded students threatens the very core of McMaster's strategic advantage by increasing student faculty ratios and class sizes and reducing our ability to provide an experiential learning environment. The University will closely monitor the student quality and financial impact of the increase in enrolment on the three year financial plan to 2010.

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

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

Key Financial Indicator 2 – Increase and Diversify Revenues

In 2007/08, the University experienced an increase in its annual revenues. The increase to $732 million was a 0.14% increase over 2006/2007. Translated into revenue per FTE enrolment of $31,200, this is 2.2% lower than 2006/07. This decrease in per student funding highlights the challenge to provide for a quality education experience and cover inflationary costs.

The diversity of the University's revenue sources improved slightly in 2007/08 and its reliance on government grants decreased to 29% of total revenue compared to 30% in 2006/07. A 1% increase in tuition revenue from 17% to 18% of total revenue reflected the additional students and higher tuition fees.

Operating Grants Income

Government operating grants of $199.9 million decreased by $.4 million over 2006/07. The 2006/07 figure included $13.1 million of one time Post Secondary Education (PSE) transfers from the Federal Government flowed through by the Province. These grants were not available in 2007/08.

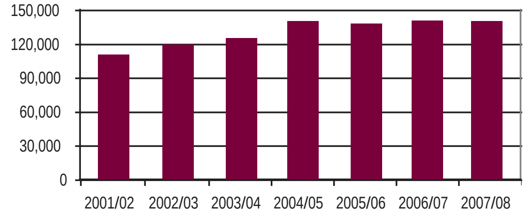
Over the past few years, the MTCU has tied increases in operating funding to specific performance outcomes such as increasing enrolment. Accessibility (growth) funding is received based on each University's share of the year over year growth. In 2007/08 McMaster received $39.2 million (an increase from $34.3 million in 2006/07), representing its full share of undergraduate growth funding. Some of this funding was provided on a one time basis. Early indications are that little, if any, accessibility funding is available for additional growth in 2008/09.

Research Grants and Contracts

Research revenue is recognized as income in the year in which the expense occurs. Unspent research revenue and revenue received for capital projects is deferred and recorded as Deferred Contributions on the Statement of Financial Position. Before allowing for deferrals, $179.1 million (2006/07-$171.7 million) was received for future use. After deferrals, research revenue recognized over the past year has decreased 0.4% to $140.6 in 2007/08 (2006/07-$141.1 million).

The revenue recognized by the University does not include hospital research, or funding for Networks of Centres of Excellence such as the new $15 million Centre for Probe Development and Commercialization hosted by McMaster University. However, these related ventures also reflect McMaster's success in creating internationally recognized centres of research excellence, building the infrastructure to support strategic research areas and integrating scholarship with teaching.

Research Revenue Recognized
$ 000's



Despite the competition among Canadian universities for research funding, future prospects for increased growth are strong. In the 2007 rankings of Canada's top 50 research universities by Research Infosource Inc., McMaster ranked second (2006/07-first) in the country in research intensity and sixth (third in 2006/07) in its ability to capitalize on its research income.

	$ millions	
RESEARCH REVENUE RECOGNIZED	**2008**	**2007**
Federal Government	103.9	101.7
Province of Ontario	9.2	13.9
Other sources	66.0	56.1
Total research funds received	179.1	171.7
Less: amount deferred to future	(38.5)	(30.6)
	140.6	**141.1**

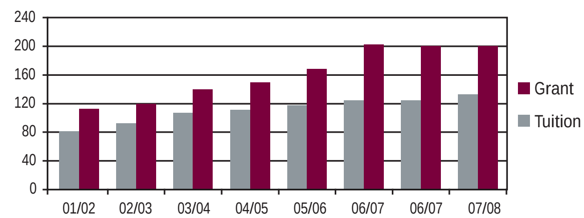
Research Overhead Grants

Research overhead grants assist the University in funding the indirect costs of research. In 2007/08, $14.6 million was received (2006/07-$14.2 million). The Province and the Federal Government funds a portion of overhead costs associated with the federal research granting councils and eligible provincial research programs.

Tuition Fees

Revenue from tuition fees has increased by 7.2% in 2007/08 as a result of a 2.6% growth in students and an increase in tuition fees as allowed by the Province. In March 2006, the Province announced a tuition fee setting policy, covering 2006/07 to 2009/10, which permits the University to increase tuition fees for regulated programs by an overall maximum of 5% per year. In 2007/08, the University increased fees by the maximum allowable increase for each regulated program. The ratio of tuition-to-grant revenue has increased in 2007/08 as a result of the increase in the number of students and the average fee per student.

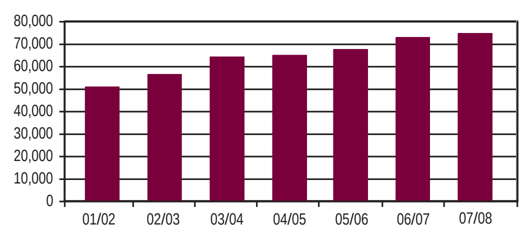
Operating Grant vs Tuition Income
$ millions



Ancillary Operations

Ancillary operations have a mandate to provide excellent services and operate in a business savvy manner. They are required to cover all operating and expansion related costs while offering services at affordable and competitive prices. Cost containment is critical to maximizing profits targeted for reinvestment and provision of student services. Currently $1.2 million in profits from the Bookstore, Hospitality and Conference Businesses is used in support of student services and to fund scholarships provided to students. Gross sales grew by 2.5% to $74.9 million in 2007/08.

Ancillary Sales Growth
$000's



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

	$ thousands		
SALES BY ANCILLARY OPERATIONS	**2007/08**	**2006/07**	**% increase**
Bookstore	22,347	21,508	3.9%
Hospitality Services	18,424	17,401	5.9%
Housing and Conference Services	19,322	18,442	4.8%
Printing	3,939	5,131	(23.2%)
Parking	3,809	3,768	1.1%
Continuing Education	2,626	2,471	6.3%
Telecommunications	2,684	2,731	(1.7%)
Student Health Services	1,602	1,447	10.7%
Miscellaneous	147	162	(9.3%)
	74,900	73,062	2.5%
Less: internal sales	(10,492)	(8,924)	17.6%
	64,408	**64,138**	**0.4%**

Hospitality Services and Housing and Conference Services revenue benefited from the 2.6% increase in enrolment. The reduction in Printing Services is due to the expiration of the regional printing agreement. Costs in that area have been reduced to reflect the lower level of services being provided.

Investment Income

Investment income reflected in the Statement of Operations was $23.1 million (2006/07-$40.1 million). These revenues reflect weak investment markets with an annual net rate of return to April 30 from the long term investment pool of (0.1)%, somewhat offset by positive returns for the working capital pool.

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 market value of endowment capital. In 2007/08, approximately $13 million (2006/07- $10 million) of expenses were funded through external endowment income, a significant proportion of which was directed towards student scholarships and bursaries and faculty compensation. This year, in order to fund the $13 million and make up the loss of $4.1 million allocated to externally restricted endowments, $17.2 million was transferred from External Endowments from investment income earned in previous years.

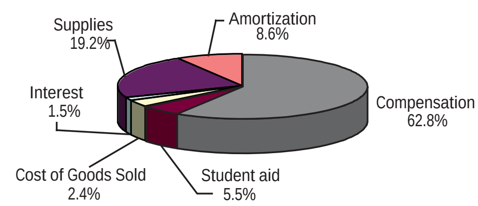
OTHER SOURCES OF REVENUE

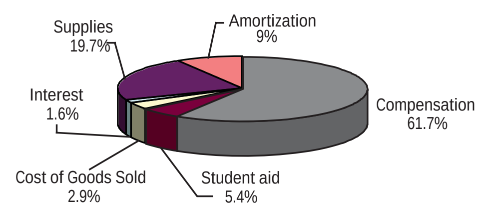
Other sources of revenue include:

- $77.9 million earned through various non-degree educational and other revenue-generating activities (2006/07-$71.1 million). Faculties accounted for $65.7 million (2006/07 - $57.2 million), and Student Services accounted for $9.4 million (2006/07 - $ 9.1 million).
- $37.7 million of restricted donations and other grants recognized in income based on expenses incurred in the year (2006/07-$38 million).
- $41 million to recognize the amortization of capital assets funded through deferred capital contributions (2006/07-$38.3 million).

Key Financial Indicator 3 – Strategic Deployment of Resources

Total expenses for 2007/08 increased by 5.4% to $745.5 million. The breakdown by category of expense for each of the last two years is illustrated in the graphs to the right.



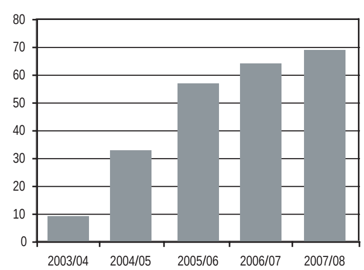


Compensation

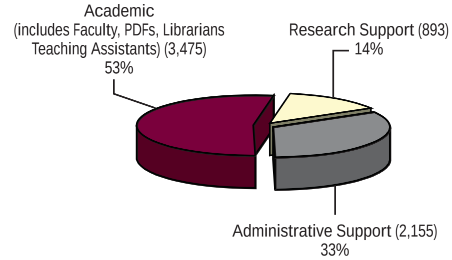
A total of 6,523 permanent staff members were employed in October 2007 (October 2006-6,405) with approximately 67% of these employees being involved in direct academic and research activities and 33% in administrative support.

Over the past several years, compensation has continued to account for an increased share of total expenditures. Total compensation expense of $468.3 million represents 62.8% of total expenses. The increase from 61.7% in 2006/07 is the result of increased faculty and staff (1.8%), salary adjustments and accelerating costs of providing employee pension and other retirement benefits. A faculty retirement incentive program was approved by the Board of Governors in March 2007. The costs associated with the program ($7 million) are reflected in 2007/08 compensation expenses.

Employee benefits increased by 8.8% from 2006/07 and grew as a percentage of salaries and wages from 30.4% to 30.9%. The second special pension deficit amortization payment of $8.1 million is included in 2007/08 expenditures. The expenses related to pension and other future employee benefits dominate the increase in total benefit costs. While some positive steps have been taken to manage the rate of growth of pension and non-pension future benefits through changes in plan design, these costs continue to put pressure on operating and research budgets.



McMaster offers defined benefit plans that provide non-pension retirement benefits including extended health, dental and life insurance for substantially all of its full-time employees. The University continues to fund these future non-pension benefits on a cash basis and has budgeted $5.3 million for 2008/09. The shortfall between the unfunded accrued value of the benefits earned ($22 million) and the cash cost of the benefits paid to retirees (2007/08 - $4.5 million) is building an unfunded accrued benefit obligation for the University. The sheer size of this obligation in relation to McMaster's financial resources creates a significant risk to the University. Using its limited financial capacity to fund these growing obligations annually will put considerable pressure on other mission-critical expenditures and threatens its future competitive position. In 2007/08, the Finance Committee directed management to produce a plan for review by the Committee providing for the level of non-pension post retirement employee benefits to become comparable with the level of such benefits at McMaster's comparator group of universities, over such reasonable time period as management



suggests, whilst maintaining the quality of the institution. The results of this review may impact the funding required for non-pension employee future benefits in the future.

It is apparent that with compensation costs escalating at a rate greater than revenue, cost saving measures will need to be continued to establish long term sustainability. McMaster's continued success depends ultimately on the recruitment and retention of high-quality faculty, staff and students, and the support of excellent management and staff. The balancing of revenues with expenditures represents a significant risk. Any future reduction of faculty and staff, together with the increase in student numbers may have many direct and indirect consequences, including:

- decreased numbers of faculty at the same time as graduate and undergraduate student numbers are increasing, leading to:
  - increased student-to-faculty ratios
  - larger class sizes
  - scheduling problems for the limited number of large classrooms
  - cancellation of courses or sections
  - inability to meet graduate student enrolment targets because of a lack of supervisory capacity
  - increased numbers of part-time instructors
- reduction in research productivity and hence reputation by:
  - increased teaching time and increased numbers of students to teach reducing research time
  - increased graduate student numbers leading to crowded facilities
  - decrease in the number of faculty members, leading to a decrease in overall research funding
- increased workload for faculty and staff, leading to difficulty in attracting and retaining the best candidates and
  - increased stress and ill health
  - lack of stability at managerial levels

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

In December 2006, Senate and the Board of Governors approved the Teaching-Stream faculty position. The teaching-stream positions have been designed to deal with two closely related issues: the existence of long-term Contractually Limited positions and the desire to develop a small number of new positions for people who will specialize in teaching. Educational specialists of this type can cost effectively enhance McMaster's significant international reputation in teaching and learning. Appointments in this category began in 2007/08, and as of July 1, 2008, 30 such positions have been appointed.

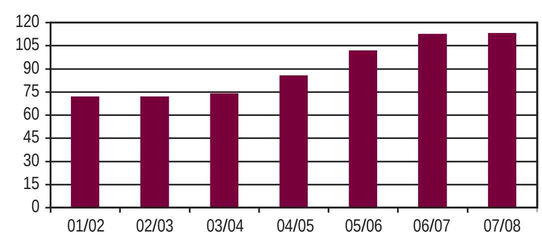
Under the Faculty Incentive Retirement Plan, incentives were granted where base budget savings were generated and where the departure did not weaken the ability of the University to achieve the mission. The purpose of the plan was twofold: to achieve the required base budget reductions, and to facilitate faculty renewal. As of July 1, 2008, 55 faculty members have taken advantage of this package and 39.5 strategic replacements have been hired or are planned.

Student Financial Aid

Student aid (scholarships and bursaries) of $40.9 million increased by 7.7% (2006/07-$37.9 million).

To provide support for funding the growing need for financial assistance, McMaster has increased endowments held for scholarships and bursaries from $112 million in 2006/07 to $113 million in 2007/08.

Funds held for Scholarships and Bursaries
$ millions



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

Capital Planning and Management

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

McMaster currently has a deferred maintenance backlog estimated at $125 million, or 9% of replacement value. The MTCU facilities replacement program grants of $9.2 million (March 2008) and $13.5 million (June 2008) have been allocated to deferred maintenance projects.

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

Projects with long term funding sources such as student levies, user fees, parking levies, and future fundraising are currently being financed through internal loans. Internal loans have grown from $32.8 million in 2006/07 to $49.1 million 2007/08 and have various recovery terms and periods.

In December 2007 the Board approved a new Debt Policy, which included specific benchmark ratios and general guidelines for project priorization and funding decisions. As of April 30, 2008, the University's balance sheet resulted in the Expendable Resources to Debt ratio (1.2) exceeding the benchmark (.8). When calculated on a three year average, the ratio is 1.4. Due to the deficiency of revenue over expenses this year ($13.5 million), the University's Interest Coverage ratio of 1.8 (one year) did not meet its benchmark of 3.0. The average interest coverage ratio over the last three years is 3.5.

No additional external borrowing was undertaken in 2007/08. Work is underway to finalize the priorization process for projects requiring funding. The University continues to monitor its debt policy ratio projections and its cash flow requirements in making the decision about the amount and timing of future external borrowing.

MAJOR BUILDING PROJECTS

PROJECT	BUDGET	FUNDING SOURCES	EXPECTED COMPLETION
Ronald V. Joyce Stadium (includes underground parking)	$35.7 million	Parking fees, pledges and fundraising	2008
Fit out of 2nd Floor of MDCL	$18.5 million	Fundraising, University	2009
New Engineering Building	$48 million	MTCU, research grants, fundraising, University	2009
Deferred maintenance projects	$9.2 million	MTCU 2007/08 year end grants	2009
Surgical Skills Lab	$3.1 million	MTCU grant and University	2009

Investment in Capital Assets

McMaster expended $94.8 million for capital acquisitions in 2007/08. These expenditures are outlined in the chart below.

CAPITAL ASSET ADDITIONS	2007/08 thousands
Completed building projects and construction in progress	$ 54,195
Computers, furnishings and other equipment	35,053
Library materials	5,530
	$ 94,778
FUNDING SOURCE FOR ADDITIONS	
Deferred capital contributions	$ 40,756
Internally funded (includes internal loans)	54,022
	$ 94,778

Strategic Deployment of Resources – Looking Forward

Over the past year, a number of committees and task forces have been established to support the implementation of the *Refining Directions* strategic plan. With an emphasis on planning, teaching and evaluation, these task forces will develop strategies and initiatives that will form the basis for resources to be strategically allocated to support the University's mission while ensuring long-term financial sustainability.

The University has established principles regarding the use of debt and recently revised its debt management processes. Implementation of the new debt management policy has begun and will include a revised capital prioritization process.

Key Financial Indicator 4 – Strong Financial Position and Management of Business Risks

The April 30, 2008 Statement of Financial Position reflects the University's decisions to use the balance sheet's strength to address short term financial needs, thereby preserving academic quality today.

We will continue to face challenging decisions that will be amplified by general economic conditions

STRENGTHS OF THE FINANCIAL POSITION

- total assets amounted to $1.74 billion compared to $1.65 billion in 2006/07, a growth of 5.3%.
- net invested in capital assets increased by $32.2 million to $194.3 million.
- departmental carry-forwards of $59.4 million increased by $9.9 million, signaling positive in year results for many departments.
- long-term debt per FTE student decreased to $6,795.

CHALLENGES TO THE FINANCIAL POSITION

- current liabilities and long term obligations of $500.8 million increased by $51.1 million over 2006/07, primarily due to the increases in accounts payable and accrued employee future benefits.
- operating net assets, which include unrestricted, employee future benefits and specific purpose reserves declined by $28.4 million. The decline of $23.2 million in the pension and employee future benefits reserve resulted from the required pension and employee future benefit liability increases.
- internal loans to capital projects increased to $49.1 million (2006/07-$32.8 million).
- total endowment per FTE student decreased from $21,800 to $20,900.

Internal and External Endowments

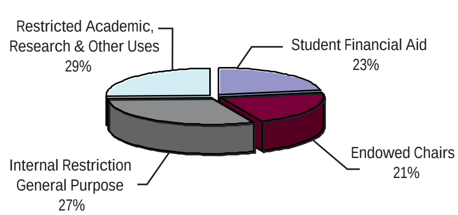
Endowments are comprised of externally restricted donations as well as other funds that have been internally restricted by the Board of Governors. Investment income on permanent external endowments is recorded in the statement of operations when this income is made available for spending in accordance with the University's preservation of capital policy. This policy was established in 2005 with the objective of protecting the real value of the endowments and providing a stable funding source for expenditures. The policy limits the amount of net income for spending to 4% and requires the reinvestment of net income in excess of that amount. In any particular year, should net investment income be insufficient to fund the amount to be made available for spending or if the investment return is negative, the amount that is made available for spending is funded by the accumulated reinvested income from prior years. In 2007/08 there was an investment loss of $4.1 million allocated to the externally restricted endowments. In accordance with the preservation of capital policy, this loss and the amount made available for spending of $13.1 million, which total $17.2 million, were deducted from endowment net assets. The amount made available for spending of $13.1 million was recorded as income in the statement of operations. After recording endowed donations of $13.9 million, the market value of the University's permanent external endowment decreased by $3.3 million year over year. Total external endowments, including endowment income that was allocated and not yet spent, increased to $356.9 million (2006/07 - $343.7 million).

Internal Endowments declined to $133.2 million (2006/07 – $154.8 million) primarily as a result of the Board approved expenditures of $7 million (Faculty Retirement Incentive Program), and $8.4 million (primarily the pension amortization payment) from the Pension Surplus portion of the Internal Endowment. In addition, the annual allocation of $5.5 million to the Operating Fund along with an investment loss in the year, resulted in a total reduction of $21.2 million in Internal Endowments. The University will continue with its plan to use another $8.1 of internal endowments in 2009 to fund salaried pension plan deficit payments that are expected to be recovered from operating funds over a long-term period. The terms of the recovery plan have not been finalized.

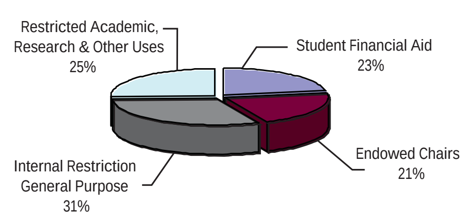
The endowment fund investment policy requires diversification between fixed income (40%) and equity securities (60%) and generated an annual rate of return, measured at March 31, 2008, of (1.1%) (2006/07 - 10.7 %), which was equivalent to the policy benchmark. Under the direction of the Investment Committee, the University regularly reviews its asset mix and monitors the performance of its investment managers.

Investment returns on endowed funds support strategic areas of expenditures. Funds for student scholarship and bursaries represent 23% of total endowments and funds held to support faculty salaries and research activities through the endowed chairs program represent 21%. Restricted Academic Research and other uses represent 29% of the total endowments held.

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



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



Employee Future Benefits (Pension and Other)

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

CHANGE IN FUNDED STATUS OF PENSION BENEFIT PLANS

	$ millions
Funded status, April 30, 2007	(98.8)
Costs in the period:	
Current service cost	(33.7)
Interest on liabilities	(63.3)
Actual return on plan assets	(26.0)
	(123.0)
Actuarial gain related to changes in discount rate and salary assumptions	21.1
Actuarial gain related to new valuation	1.0
University contributions	41.6
Funded status, April 30, 2008	**(158.1)**

Pension

The funded status of the defined benefit pension plans, measured at April 30, 2008, is a deficit of $158.1 million (2006/07-deficit of $98.8 million).

The change in the funded status of the defined benefit pension plans from April 30, 2007 to April 30, 2008 is summarized in the chart to the left.

Investment returns were lower than expected and along with the current service cost and interest on liabilities these factors generated a net increase in the deficit position. This increase was somewhat mitigated by changes in actuarial assumptions and the impact of a change in the discount rate to 6.25% from 5.3% ($21.1 million). This discount rate increase had a sizable impact on the funded position due to the long (17 year) duration of the liabilities. There was no change to the expected long-term rate of return on plan assets at 7.0%.

The pension expense for 2007/08 of $41.9 million was unchanged from the expense for 2006/07 and includes amortization of actuarial losses of $15.4 million (2006/07-$14.4 million).

The University submitted its funding valuation for the pension plans as of July 1, 2007 and is required to submit the next funding valuations as of July 1, 2010. Based on the results of the July 1, 2007 valuation, the University will continue with the plan to fund minimum deficit payments for 2008/09 from the internally restricted endowment and continue with the plan to fund the current service cost at 210% of employee contributions through budget envelopes for 2008/09.

Other - Post Retirement and Post Employment Benefit Plans

The deficit status of the non-pension post retirement benefit plan as at April 30, 2008 amounted to $203.1 million, a decrease of $20.2 million from April 30, 2007.

The significant changes are outlined in the chart to the right.

A full actuarial valuation was completed in May 2007 and extrapolated to April 30, 2008. The discount rate is based on high quality corporate bond yields as at April 30, 2008, resulting in an increase in the rate of 1%, which accounts for the decrease in the liability.

Non-pension future employee benefit expense in 2007/08 of $27.2 million increased by $5 million from 2006/07. The increase reflects higher current service and interest costs, as well as the requirement to amortize $5.2 million of previously unamortized actuarial losses.

The University continues to fund future non-pension benefits on a cash basis and has budgeted $5.3 million in 2008/09. This amount is consistent with estimates provided by the actuaries. Under the direction of the Finance Committee of the Board of Governors, the University is currently reviewing its plan to manage non-pension post retirement benefits.

The University is reviewing its plan to manage non-pension post retirement benefits

CHANGE IN FUNDED STATUS OF NON-PENSION BENEFIT PLANS

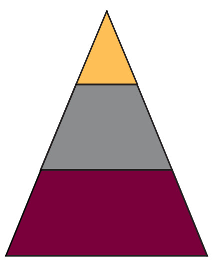
	$ millions
Funded status, April 30, 2007	(223.3)
Costs in the period:	
Current service cost	(9.9)
Interest on liabilities	(12.1)
	(22.0)
Actuarial gain related to change in assumptions for discount rate	37.2
Other	0.5
University contributions	4.5
Funded status, April 30, 2008	**(203.1)**

Risk and Control Environment Management

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

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

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



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

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

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

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

The Group 1 risk monitoring process includes the compilation of risk registers for each of the distinct risk categories and a scoring of the risk elements within the registers as to the likelihood of occurrence of a risk event and the impact (materiality) of the event on the University.

The scored risks are compiled into a table for composite rankings and cross comparisons by Management, a process which draws attention to the significance of the risks and aids in planning resource needs and management activity.

The Internal Audit Plan then considers the linkages among enterprise, business processes, protection of assets and business activities in the effort to direct the monitoring and audit efforts according to the significance of the composite risk rankings.

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

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

Summary

Overall, the University maintained its role as one of Canada's leading student centred, research intensive institutions despite the significant financial challenges faced by the University in 2007/08.

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

1. *Strong demand for programs* continued and the University continued to exceed its enrollment targets for Undergraduate students.
2. *Increasing and diversifying the revenues* was challenged in 2007/08 by limits to our control over revenues and fee setting autonomy.
3. *Strategic deployment of resources* was challenged by the growth in salary and wage costs at a rate greater than the increase in revenue and by the need to balance short term operational needs with the long term financial health of the University.
4. *Maintenance of the strong financial position* was challenged by the decision to fund the special deficit pension payments and the faculty retirement incentive plan from internally restricted endowments. Management of the business risks was maintained by enhanced monitoring of the Enterprise Wide Risk Management Program and the adoption of the Debt Management Policy.

The University will not lose sight of the long-term vision and our commitment to manage its financial challenges, including making progress on the funding of expenses not currently accounted for in the operating fund budget, such as the full cost of post employment benefits. The University will continue to focus attention on revenue generation, control of rising benefit costs and strategic deployment of resources to support the mission and vision of the institution.

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 half of all spending. The Operating Fund Budget does not include the accrued costs of post retirement benefits, special payments to fund the salaried pension plan deficit and the cost of the Faculty Retirement Incentive Program.

The 2007/08 Operating Budget reflected the first year of the three year plan to:

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

Considerable attention and effort focused significant resources on addressing the deficit and the University finished the year with a small (2.4%) surplus.

2007/08 OPERATING FUND - $ millions					
				Variance	
	Budget	Projection[1]	Actual	Budget vs. Actual	Projection vs. Actual
Sources of revenue	$ 394.5	$ 412.6	$ 421.0	$ 26.5	$ 8.4
Less: expenditures	410.3	413.7	409.9	0.4	3.8
Add: amount funded by (transferred to) unrestricted net assets	0.2	–	(1.2)	(1.4)	(1.2)
Excess (deficiency) of revenue over expenditures	(15.6)	(1.1)	9.9	25.5	11.0
Fund balance, beginning of year	49.5	49.5	49.5	–	–
Fund balance, end of year	$ 33.9	$ 48.4	$ 59.4	$ 25.5	$ 11.0

Total operating fund revenues were $421 million as compared to the projected funding of $412.6 million. The favourable variance of $8.4 million (2%) is primarily due to increased recoveries and other income.

Total operating fund expenditures were $409.9 million as compared to projected expenditures of $413.7 million. The favourable variance of $3.8 million (0.9%) is due primarily to a reduction in salary and wage expense offset by higher than projected non-salary spending.

As a result, the excess of revenues over expenditures increased to $9.9 million, which is $11 million more than projected. These appropriations provide funds to offset future deficits expected in some envelopes in 2008/09 as the strategies to reduce structural deficits are implemented.

1 Completed based on nine months of acutal results

Financial Statements – April 30, 2008

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McMaster University

Statement of Management Responsibility

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

The management has prepared the financial statements in accordance with Canadian generally accepted accounting principles developed by The Canadian Institute of Chartered Accountants. The management believes the financial statements present fairly the University's financial position as at April 30, 2008 and the results of its operations, changes in net assets and its cash flows for the year then ended. In order to achieve the objective of fair presentation in all material respects, the use of reasonable estimates and judgements were employed. Additionally, management has ensured that financial information presented elsewhere in this Annual Financial Report has been prepared in a manner consistent with that in the financial statements.

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

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

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

The financial statements for the year ended April 30, 2008 have been reported on by KPMG LLP, Chartered Accountants, the auditors appointed by the Board of Governors. The Auditors' Report outlines the scope of their audit and their opinion on the presentation of the information included in the financial statements.

Dr. P. George	Ms. K. Belaire
President and Vice-Chancellor	Vice-President, Administration
August 1, 2008	August 1, 2008

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, 2008 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, 2008 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Hamilton, Canada
August 1, 2008

McMASTER UNIVERSITY
Statement of Financial Position
April 30, 2008, with comparative figures for 2007
(thousands of dollars)

	2008	2007
Assets		
Current assets:		
Cash and equivalents	$ 112,571	$ 88,107
Government grants and other accounts receivable	44,640	44,699
Research grants receivable	80,729	73,416
Inventories	4,414	4,729
Prepaid expenses	4,995	4,752
	247,349	215,703
Investments (note 3)	614,020	588,398
Investment in McMaster Innovation Park (note 4)	13,318	13,318
Capital assets (note 5)	644,744	613,812
Deferred pension asset (note 6)	222,282	222,972
	$ 1,741,713	$ 1,654,203
Liabilities, Deferred Contributions and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 95,862	$ 75,089
Deferred revenue	34,466	30,267
Current portion of long-term obligations	997	937
	131,325	106,293
Accrued employee future benefits (note 6)	205,058	182,651
Long-term obligations (note 7)	164,402	160,755
Deferred contributions (note 8):		
Deferred for future expenses	269,295	211,374
Deferred capital contributions	299,489	299,796
	568,784	511,170
Net assets:		
Operating:		
Unrestricted	1,807	4,929
Internally restricted (note 9)	55,790	81,056
Equity in capital assets (note 10)	194,265	162,106
Endowments (note 11):		
Internal	133,166	154,823
External	287,116	290,420
	672,144	693,334
Commitments and contingencies (note 12)		
	$ 1,741,713	$ 1,654,203

On behalf of the Board of Governors:

____________________ Chair, Board of Governors

____________________ President and Vice-Chancellor

See accompanying notes to financial statements

McMASTER UNIVERSITY
Statement of Operations
Year ended April 30, 2008, with comparative figures for 2007
(thousands of dollars)

	2008	2007
Revenue:		
Operating grants	$ 199,915	$ 200,340
Research grants and contracts	140,613	141,142
Tuition fees	132,723	123,761
Ancillary sales and services	64,408	64,138
Other	77,923	71,087
Investment income, net	23,112	40,052
Donations and other grants	37,695	38,023
Research overhead grants	14,553	14,155
Amortization of deferred capital contributions	41,047	38,268
	731,989	730,966
Expenses:		
Salaries and wages	357,644	334,776
Employee benefits	110,638	101,671
Supplies and services	202,236	197,140
Interest on long-term debt	11,144	11,145
Share in loss of McMaster Innovation Park	-	142
Amortization of capital assets	63,846	62,430
	745,508	707,304
Excess (deficiency) of revenue over expenses	$ (13,519)	$ 23,662

McMASTER UNIVERSITY
Statement of Changes in Net Assets
Year ended April 30, 2008, with comparative figures for 2007
(thousands of dollars)

	Operating							
		Internally restricted						
		Employee future benefits	Specific purposes	Equity in capital assets	Endowments			
	Unrestricted				Internal	External	2008 Total	2007 Total
Net assets, beginning of year:								
As previously reported	$ 4,929	9,395	71,661	162,106	154,823	290,420	693,334	628,733
Change in accounting policy (note 2)	(3,885)	-	-	-	-	-	(3,885)	-
As restated	1,044	9,395	71,661	162,106	154,823	290,420	689,449	628,733
Excess (deficiency) of revenue over expenses	9,280	-	-	(22,799)	-	-	(13,519)	23,662
External endowment contributions:								
Contributions	-	-	-	-	-	13,937	13,937	22,186
Protection of capital	-	-	-	-	-	(17,241)	(17,241)	18,753
Transfers and adjustments:								
Transfers for specific purposes	25,266	(23,166)	(2,100)	-	-	-	-	-
Capital transactions from operating (note 10)	(54,958)	-	-	54,958	-	-	-	-
Transfer from internal endowments	21,657	-	-	-	(21,657)	-	-	-
Net change in unrealized losses on interest rate swap contracts (note 7)	(482)	-	-	-	-	-	(482)	-
	763	(23,166)	(2,100)	32,159	(21,657)	(3,304)	(17,305)	64,601
Net assets, end of year	$ 1,807	(13,771)	69,561	194,265	133,166	287,116	672,144	693,334

See accompanying notes to financial statements

McMASTER UNIVERSITY

Statement of Cash Flows

Year ended April 30, 2008, with comparative figures for 2007

(thousands of dollars)

	2008	2007
Cash flows from operating activities:		
Excess (deficiency) of revenue over expenses	$ (13,519)	$ 23,662
Adjustments for non-cash items:		
Amortization of deferred capital contributions	(41,047)	(38,268)
Amortization of capital assets	63,846	62,430
Increase in accrued employee future benefits	22,407	16,838
Increase in decommissioning obligation	276	264
Change in deferred pension asset	690	2,437
Share in loss of McMaster Innovation Park	-	142
	32,653	67,505
Net change in contributions deferred for future expenses	57,921	7,497
Net change in non-cash working capital	17,790	(13,971)
	108,364	61,031
Cash flows from financing and investing activities:		
Purchase of capital assets	(94,778)	(105,400)
Net increase in investments	(25,622)	(50,286)
Net change in external endowments	(3,304)	40,939
Deferred capital contributions	40,740	53,473
Principal repayments on long-term obligations	(936)	(881)
	(83,900)	(62,155)
Net increase (decrease) in cash	24,464	(1,124)
Cash and equivalents, beginning of year	88,107	89,231
Cash and equivalents, end of year	$ 112,571	$ 88,107

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

1. Significant accounting policies:

(a) Basis of presentation:

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

Independent entities:

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

Other entities:

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

The investment in the related entity, McMaster Innovation Park ("Park") is accounted for by the equity method (note 4). 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(k)) are recognized as a direct increase in endowment net assets. Income earned from the investment thereof, to the extent it is allocated, is recorded as deferred contributions and recorded as revenue in the periods in which the related expenses are incurred.

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

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

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

1. Significant accounting policies (continued):

(c) Investments:

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

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

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

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

(d) Inventories:

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

(e) Capital assets:

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

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

(f) Collections and works of art:

The McMaster Museum of Art has significant collections of works of art and coins. Acquisitions and donations of works of art amounted to $261,000 (2007 - $125,000) and are charged to operations in the year of acquisition.

(g) Contributed services:

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

(h) Ancillary enterprises:

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

1. Significant accounting policies (continued):

(i) Employee future benefits:

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

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

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

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

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

(j) Net assets:

Net assets are classified as follows:

Operating:

Unrestricted: operating funds available without specific restrictions.

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

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

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

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

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

1. Significant accounting policies (continued):

(k) Endowment capital protection policy:

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

(l) Derivative financial instruments:

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

(m) Decommissioning obligation:

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

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

(n) 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.

(o) 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.

(p) Future accounting policy changes:

The Canadian Institute of Chartered Accountants ("CICA") has issued two new standards, CICA 3862 "Financial Instruments – Disclosures" and CICA 3863 "Financial Instruments – Presentation", which enhance the abilities of users of financial statements to evaluate the significance of financial instruments to an entity, related exposures and the management of these risks.

The CICA has also issued a new accounting standard, CICA 1535 "Capital Disclosures", which requires the disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital.

These changes will be adopted effective May 1, 2008 and will only require additional disclosures.

2. Changes in Accounting Policies:

Effective May 1, 2007, the University adopted the new CICA Handbook Sections 3855 "Financial Instruments - Recognition and Measurement", 3865 "Hedges" and 3861 "Financial Instruments – Presentation and Disclosure". Pursuant to the requirements, these standards have been adopted prospectively with no restatement of prior periods. The adoption of these standards has given rise to the recognition of certain transition adjustments in the opening balance of unrestricted net assets.

(a) Financial Instruments – Recognition and Measurement

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

The University has classified its financial instruments as follows:

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

The University has elected to expense transaction costs related to financial instruments classified as other than held-for-trading.

The University has elected to use trade date accounting for regular-way purchases and sales of financial assets. The University has elected not to separately account for embedded derivatives.

(b) Hedges

Section 3855 stipulates that all derivative instruments should be 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.

In accordance with the standards, the University's interest rate swap contracts 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. In prior years, no value was recorded for the interest rate swap contracts on the statement of financial position.

As required by the transitional provisions of the standards, the change in accounting policy was adopted prospectively, without restatement of the prior year's financial statements. The impact on the statement of financial position as at May 1, 2007 of recording the derivative contracts at fair value is an increase in interest rate swap contracts of $3,885,466 and a decrease in unrestricted net assets of $3,885,466.

3. Investments:

Details of investments are as follows:

(thousands of dollars)	2008		2007	
	Fair Value	Cost	Fair Value	Cost
Equities:				
Canadian	$ 134,459	$ 101,840	$ 121,524	$ 90,820
United States	94,810	103,047	103,581	93,190
Non-North American	106,482	108,621	118,004	98,142
	335,751	313,508	343,109	282,152
Fixed income	$ 272,443	$ 267,965	$ 241,652	$ 238,998
Other	5,826	5,335	3,637	3,770
	$ 614,020	$ 586,808	$ 588,398	$ 524,920

All investments are classified as held-for-trading except for the strip bonds held for the Hedden residence sinking fund which is classified as held-to-maturity.

4. Investment in McMaster Innovation Park:

Details of the investment are as follows:

(thousands of dollars)	2008	2007
Balance, beginning of year	$ 13,318	$ 13,460
Share in cumulative losses	-	(142)
Balance, end of year	$ 13,318	$ 13,318

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

4. Investment in McMaster Innovation Park (continued):

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

(thousands of dollars)	December 31 2007	December 31 2006
Total assets	$ 27,748	$ 27,089
Total liabilities	$ 1,143	$ 103
Total deferred revenue and capital grants	13,287	13,668
Total trusts' equity	13,318	13,318
	$ 27,748	$ 27,089
Results of operations:		
Total revenue	$ 1,306	$ 1,910
Total expenses	1,306	2,084
Loss for the year	$ -	$ (174)
Cash flows:		
Cash flows from operating activities	$ 562	$ 1,366
Cash flows from financing and investing activities	(2,201)	6,651
Increase (decrease) in cash	$ (1,639)	$ 8,017

Included in accounts receivable at April 30, 2008 is $111,419 receivable from McMaster Innovation Park (2007 - $6,821,156 was included in accounts payable and accrued liabilities).

In addition to the information disclosed elsewhere, the University had the following related party transactions with the Trusts for their year ended December 31, 2007:

- provided payroll services at a fee of 1% of total salaries paid ($3,634);
- paid rent in the amount of $72,000 (2006 - $86,400).

In June 2008, the Board approved a McMaster Innovation Park capital financing request up to $15,700,000 under which the University will provide cash advances to the Park at the University's central bank rate. Advances amounted to $4,606,309 as at August 1, 2008.

5. Capital assets:

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

5. Capital assets (continued):

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

6. 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)	2008		
	Pension		
	Registered	Supplemental	Other
Accrued benefit obligation	$ 1,149,749	$ 67,653	$ 203,126
Fair value of plan assets	1,059,331	-	-
Funded status - deficiency	(90,418)	(67,653)	(203,126)
Reconciliation to deferred benefits (accrued future benefits):			
Unamortized past service cost	(3,472)	2,474	-
Unamortized actuarial loss	316,172	4,007	59,240
Deferred pension asset (accrued employee future benefits)	$ 222,282	$ (61,172)	$ (143,886)

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

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

6. Employee future benefits (continued):

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

(thousands of dollars)	2008		2007	
	Pension	Other	Pension	Other
Net benefit expense	$ 41,940	$ 27,186	$ 41,941	$ 22,235

(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	65.6%	65%	8.3%
Debt securities	33.8%	35%	4.6%
Other	0.6%	0%	3.0%

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

	Pension	Other
Discount rate	6.25%	6.25%
Expected long-term rate of return on plan assets	7.0%	-
Rate of compensation increase	5.25%	4.5%

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

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

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

(thousands of dollars)	2008		2007	
	Pension	Other	Pension	Other
Employer contributions	$ 41,562	$ 4,470	$ 40,646	$ 4,254
Employee contributions	12,698	-	10,539	-
Benefits paid	56,043	4,470	49,083	4,254

(g) For measurement purposes, an 8.6% annual rate of increase in per capita medical cost was assumed for 2007, grading down to 5% per annum in and after 2015. For per capita dental costs, an annual rate of increase of 4% per annum was assumed.

6. Employee future benefits (continued):

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

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

The results of each valuation have been extrapolated to April 30, 2008, which is the measurement date used to determine the accrued benefit obligation for all employee future benefit plans.

7. Long-term obligations:

Details of long-term obligations are as follows:

(thousands of dollars)	Maturity	Interest Rate	Current portion	Non-current portion	2008 Total Outstanding	2007 Total Outstanding
Residence mortgage (a)	May 2011	9.81%	$ -	$ 11,544	$ 11,544	$ 11,544
Bank loan (b)	Dec 2012	floating	570	2,422	2,992	3,528
Mortgage	Oct 2016	5.38%	97	912	1,009	1,099
Bank term loan (c)	May 2033	floating	330	19,454	19,784	20,094
Debentures (d)	Oct 2052	6.15%	-	120,000	120,000	120,000
			997	154,332	155,329	156,265
Decommissioning obligation (e)			-	5,703	5,703	5,427
Interest rate swap contracts (f)			-	4,367	4,367	-
			$ 997	$ 164,402	$ 165,399	$ 161,692

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

2009	$ 997
2010	1,060
2011	1,128
2012	12,744
2013	1,028

(a) A sinking fund has been established to fund a portion of the principal repayment of the residence mortgage upon maturity. Increases to the fund are charged to residence ancillary operations. The value of the fund amounts to $4,766,000 (2007 - $4,422,000).

(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%.

7. Long-term obligations (continued):

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

A 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 $10,432,000 (2007 - $10,524,000).

(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, 2008, the fair value of the trust funds amounted to $6,593,000 (2007 - $6,325,000). In total, the net present value of the estimated cost for decommissioning, at April 30, 2008 is $5,703,000 (2007 - $5,427,000) using a risk free rate of 5.10%.

(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 7(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 7(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)	2008		2007	
	Notional Value	Fair Value	Notional Value	Fair Value
10-year interest rate swap	$ 2,992	$ (182)	$ 3,528	$ (158)
30-year interest rate swap	19,784	(4,185)	20,094	(3,727)
	$ 22,776	$ (4,367)	$ 23,622	$ (3,885)

The change in fair value of the swaps for the year ended April 30, 2008 are as follows:

- 10-year: ($24,000) (2007 - $33,000)
- 30-year: ($458,000) (2007 - ($564,000))

8. 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)	2008	2007
Balance, beginning of year	$ 211,374	$ 203,877
Deferred and capital contributions received	287,819	240,859
	499,193	444,736
Less:		
Amounts recognized as revenue	(189,158)	(188,767)
Deferred capital contributions transfer	(40,740)	(44,595)
Balance, end of year	$ 269,295	$ 211,374

Deferred contributions consist of the following:

(thousands of dollars)	2008	2007
Research grants and contracts	$ 159,868	$ 144,020
Donations, other grants and investment income	69,781	53,273
Capital grants and donations	36,750	9,872
Other restricted funds	2,896	4,209
	$ 269,295	$ 211,374

8. 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)	2008	2007
Balance, beginning of year	$ 299,796	$ 284,591
Add: contribution transfers	40,740	53,473
Less: amount amortized to revenue	(41,047)	(38,268)
Balance, end of year	$ 299,489	$ 299,796

9. Internally restricted net assets:

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

(thousands of dollars)	2008	2007
Employee future benefit related:		
Pensions	$ 120,876	$ 121,242
Other retirement and post employment benefit plans	(134,647)	(111,847)
	(13,771)	9,395
Specific purposes:		
Unexpended departmental carryforwards	59,439	49,527
Other	44,014	39,958
	103,453	89,485
Sinking funds	15,214	14,946
Capital projects	(49,106)	(32,770)
	69,561	71,661
	$ 55,790	$ 81,056

Included in unexpended departmental carryforwards is a $5,500,000 (2007 - $6,000,000) advance to the Faculty of Science from unrestricted net assets for which arrangements for recovery have been established.

9. Internally restricted net assets (continued):

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

Project	Funding Source	2008 Balance (thousands of dollars)
Les Prince Residence	Ancillary operations	$ (19,728)
David Braley Athletic Centre	Student levies, pledges, fundraising	(17,385)
Stadium and Parking Project	Parking fees, pledges, fundraising	(26,800)
Residence Wiring Project	Ancillary operations	(1,081)
McMaster Biosciences Incubation Centre	Rental and other income	(1,107)
Other projects (net)	Various	16,995
		$ (49,106)

Project	Funding Source	2007 Balance (thousands of dollars)
Les Prince Residence	Ancillary operations	$ (20,191)
David Braley Athletic Centre	Student levies, pledges, fundraising	(8,104)
Stadium and Parking Project	Parking fees, pledges, fundraising	(8,637)
Residence Wiring Project	Ancillary operations	(1,572)
McMaster Biosciences Incubation Centre	Rental and other income	(1,208)
Other projects (net)	Various	6,942
		$ (32,770)

10. Equity in capital assets:

The equity in capital assets is calculated as follows:

(thousands of dollars)	2008	2007
Capital assets	$ 644,744	$ 613,812
Less amounts financed by:		
Net long-term debt	(150,990)	(151,910)
Unamortized deferred capital contributions	(299,489)	(299,796)
	$ 194,265	$ 162,106

Details of the transfer for capital transactions are as follows:

(thousands of dollars)	2008	2007
Repayment of long-term debt	$ 936	$ 881
Capital asset purchases from operating	54,022	48,845
	$ 54,958	$ 49,726

11. Endowments:

(a) Internal:

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

(thousands of dollars)	2008	2007
Balance, beginning of year	$ 154,823	$ 143,878
Donations	518	280
Investment income (loss)	(1,726)	15,723
Net transfers and expenses	(20,449)	(5,058)
Balance, end of year	$ 133,166	$ 154,823

Included in internal endowments is an amount of $62,506,704 (2007 - $65,922,000) 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)	2008	2007
Balance, beginning of year	$ 290,420	$ 249,481
External contributions:		
OTSS	4,392	4,520
Other	9,545	17,666
Income retained (withdrawn) - capital protection policy	(17,241)	18,753
Balance, end of year	$ 287,116	$ 290,420

12. Commitments and contingencies:

(a) Canadian Universities Reciprocal Insurance Exchange:

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

(b) Legal claims:

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

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

(c) Capital commitments:

The estimated cost to complete approved major capital projects amounted to $78,960,000 at April 30, 2008 (2007 - $103,350,000).

(d) Leases:

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

(thousands of dollars)	
2009	$ 2,750
2010	2,430
2011	2,150
2012	1,250
2013	730

12. Commitments and contingencies (continued):

(e) Faculty Retirement Incentive Program:

Pursuant to a Board Resolution dated March 1, 2007, the University initiated a Faculty Retirement Incentive Program ("Program") which provides for the voluntary retirement of 180 eligible academic faculty. The Program's aggregate approved funding amounted to $7 million and was charged to operations during fiscal 2008.

13. Related party transactions:

In addition to transactions and balances disclosed in note 4, the University had the following transactions with:

- Fundraising entities: funds received during the year amounted to $13,103,000 (2007 - $327,000).
- Joint venture: the University's share of income (loss) amounted to $332,000 (2007 - ($12,000)).

14. 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, 2008 and 2007 in the first phase of the Ontario Student Opportunity Trust Fund (OSOTF I) balance:

(thousands of dollars)	2008	2007
Endowment balance, beginning of year	$ 32,144	$ 32,515
Investment income retained for protection of capital	1,044	(228)
Investment income transferred to expendable income	(111)	(143)
Endowment balance, end of year	33,077	32,144
Funds available for awards, beginning of year	-	-
Investment income	1,191	1,083
Bursaries awarded (2008 - 1,150 awards; 2007 - 985 awards)	(1,302)	(1,226)
Investment income transferred from endowment balance	111	143
Funds available for awards, end of year	-	-
Total funds at book value	$ 33,077	$ 32,144

The market value of the endowment as at April 30, 2008 was $33,962,000 (2007 - $35,508,000).

14. 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)	2008	2007
Endowment balance, beginning of year	$ 5,967	$ 5,989
Investment income retained for protection of capital	130	(22)
Endowment balance, end of year	6,097	5,967
Funds available for awards, beginning of year	18	13
Investment income for expenditures	184	158
Bursaries awarded (2008 - 190 awards; 2007 - 123 awards)	(180)	(153)
Funds available for awards, end of year	22	18
Total funds at book value	$ 6,119	$ 5,985

The market value of the endowment as at April 30, 2008 was $5,928,000 (2007 - $6,369,000).

15. Ontario trust for student support:

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

The following is the schedule of changes in the endowment balance and expendable funds for the years ended March 31, 2008 and 2007:

(thousands of dollars)	2008	2007
Endowment balance, beginning of year	$ 12,488	$ 7,407
Cash donations received	2,252	2,935
Funds received/receivable from MTCU	2,312	2,075
Investment income retained for protection of capital	(12)	71
Endowment balance, end of year	17,040	12,488
Funds available for awards, beginning of year	319	68
Investment income for expenditures	514	373
Bursaries awarded (2008 - 177 awards; 2007 - 78 awards)	(203)	(122)
Funds available for awards, end of year	630	319
Total funds at book value	$ 17,670	$ 12,807

16. Pledges receivable:

Outstanding but unrecorded pledges for donations and other fund raising amounted to $58,908,369 (2007 - $39,284,000).

17. Fair value of financial instruments:

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

Information concerning the fair value of investments is disclosed in note 3.

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

(thousands of dollars)	2008		2007	
	Book Value	Fair Value	Book Value	Fair Value
Long term debt:				
- with fixed interest rates	$ 132,553	$ 154,271	$ 132,643	$ 164,602
- with variable interest rates (without consideration of interest rate swaps)	22,776	22,776	23,622	23,622

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 7(f).

18. Comparative figures:

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

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