

Financial statements of

**THE ROYAL INSTITUTION FOR THE
ADVANCEMENT OF LEARNING /
McGILL UNIVERSITY**

(see Note 1)

May 31, 2007

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**
Table of contents

Auditors' report..... 1

Balance sheet 2

Statement of revenue and expenses and changes in fund balances.....3-4

Statement of cash flows 5

Notes to the financial statements6-24

Auditors' report

To the Trustee of the Royal Institution for the Advancement of Learning and the Board of Governors of McGill University:

We have audited the balance sheet of the Royal Institution for the Advancement of Learning / McGill University as at May 31, 2007 and the statements of revenue and expenses and changes in fund balances 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.

The University has prepared its financial statements in accordance with the recommendations in the *Cahier des définitions, des termes et des directives de présentation du rapport financier annuel pour les universités du Québec* (the "Cahier"), as they are applied in the annual financial report submitted to the ministère de l'Éducation, du Loisir et du Sport du Québec. These recommendations are consistent with Canadian generally accepted accounting principles with the principal exceptions relating to the accounting for accrued vacation pay, employee future benefits, capital assets, long-term grants receivable, bond discounts, and the presentation of the bond sinking fund of the long-term debt. Note 2 describes how the Cahier's recommendations differ from Canadian generally accepted accounting principles.

In our opinion, except for the effects of the accounting methods described in the preceding paragraph, these financial statements present fairly, in all material respects, the financial position of the Royal Institution for the Advancement of Learning / McGill University as at May 31, 2007, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Samson Bélaïr Deloitte & Touche s.e.n.c.r.l.

Chartered Accountants

August 10, 2007

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
MCGILL UNIVERSITY**

**Balance sheet
as at May 31, 2007
(in thousands of dollars)**

	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund	Total	
					2007	2006 (Restated Note 15)
	\$	\$	\$	\$	\$	\$
Assets						
Current assets						
Short-term investments	47,457	3,399	40,613	29,080	120,549	163,050
Receivables						
Operating	22,022	-	319	284	22,625	20,170
Student loans	-	3,500	-	-	3,500	3,741
Investment income	-	-	-	3,042	3,042	3,076
Government grants	52,614	-	527	-	53,141	43,769
Grants and contracts related to research	-	148,907	-	-	148,907	171,429
Pledges	389	18,426	-	-	18,815	10,306
Prepaid expenses	4,729	183	-	-	4,912	5,790
Inventory	1,958	-	-	-	1,958	1,452
Due from (to) other funds	(22,501)	140,932	(120,668)	2,237	-	-
	106,668	315,347	(79,209)	34,643	377,449	422,783
Marketable securities, at market value	-	474	28,198	877,768	906,440	786,725
Grants and contracts related to research receivable - long-term	-	107,892	-	-	107,892	134,774
Pledges receivable - long-term	628	35,300	-	-	35,928	25,267
Grant receivable	-	187	4,092	-	4,279	5,032
Capital assets (Note 3)	-	-	1,047,155	-	1,047,155	975,819
Other assets	-	-	6,854	-	6,854	7,570
Staff mortgages	-	-	-	1,422	1,422	1,511
Total assets	107,296	459,200	1,007,090	913,833	2,487,419	2,359,481
Liabilities						
Current liabilities						
Bank indebtedness (Note 7)	122,458	-	-	-	122,458	176,468
Accounts payable and accrued liabilities	25,817	8,960	22,253	400	57,430	53,371
Unearned revenue	15,944	-	705	-	16,649	16,107
Provisions for specific purposes	1,043	-	-	-	1,043	1,043
Current portion of long-term debt (Note 8)	-	-	56,706	-	56,706	40,717
	165,262	8,960	79,664	400	254,286	287,706
Long-term debt (Note 8)	-	187	519,802	-	519,989	477,745
	165,262	9,147	599,466	400	774,275	765,451
Commitments and contingent liabilities (Notes 12 and 13)						
Fund balances						
Invested in capital assets	-	-	404,601	-	404,601	387,824
Externally restricted (Note 4)	-	450,053	8,506	884,703	1,343,262	1,226,889
Internally restricted (Note 5)	48,671	-	(5,483)	28,730	71,918	61,268
Unrestricted	(106,637)	-	-	-	(106,637)	(81,951)
	(57,966)	450,053	407,624	913,433	1,713,144	1,594,030
Total liabilities and fund balances	107,296	459,200	1,007,090	913,833	2,487,419	2,359,481

Approved by the Board of Governors

..... Governor

..... Governor

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Statement of revenue and expenses and changes in fund balances

year ended May 31, 2007

(in thousands of dollars)

	2007					2006 (Restated, Note 15)				
	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund	Total	Total	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Revenue										
Government of Québec										
Grant	267,021	8,099	21,331	-	296,451	274,335	250,344	6,272	17,719	-
Interest on MELS bonds	-	-	20,189	-	20,189	20,276	-	-	20,276	-
Government of Canada	18,271	-	-	-	18,271	15,394	15,394	-	-	-
Tuition fees	74,146	-	-	-	74,146	72,029	72,029	-	-	-
Sale of goods and services	77,108	-	231	-	77,339	65,654	65,498	-	156	-
Gifts and bequests	4,747	6,355	4,692	36,673	52,467	44,647	3,807	5,244	9,275	26,321
Interest income on short-term investments	8,825	-	6,075	-	14,900	11,372	6,916	-	4,456	-
Net investment income (Note 10)	10,836	18,677	-	-	29,513	31,495	11,543	19,462	490	-
	460,954	33,131	52,518	36,673	583,276	535,202	425,531	30,978	52,372	26,321
Services to the community (Note 10)	18,986	33,276	-	-	52,262	43,571	18,276	25,295	-	-
Student services										
Fees and sales of goods and services	14,471	-	-	-	14,471	13,048	13,048	-	-	-
Student aid										
Net investment income (Note 10)	-	17,989	-	-	17,989	19,323	-	19,323	-	-
Donations and grants	232	19,110	-	-	19,342	18,255	329	17,926	-	-
Government of Québec grant	2,103	-	-	-	2,103	2,033	2,033	-	-	-
	16,806	37,099	-	-	53,905	52,659	15,410	37,249	-	-
Ancillary services	48,399	176	-	-	48,575	49,729	49,547	182	-	-
Research										
Net investment income (Note 10)	-	10,447	-	-	10,447	11,124	-	11,124	-	-
Government grants										
Federal	-	136,937	-	-	136,937	145,764	-	145,764	-	-
Provincial	-	23,800	-	-	23,800	39,489	-	39,489	-	-
United States	-	6,438	-	-	6,438	6,921	-	6,921	-	-
Grants from other sources	-	57,963	-	-	57,963	57,285	-	57,285	-	-
	-	235,585	-	-	235,585	260,583	-	260,583	-	-
Total revenue	545,145	339,267	52,518	36,673	973,603	941,744	508,764	354,287	52,372	26,321

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

**Statement of revenue and expenses and changes in fund balances (continued)
year ended May 31, 2007
(in thousands of dollars)**

	2007					2006 (Restated, Note 15)				
	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund	Total	Total	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue (from previous page)	545,145	339,267	52,518	36,673	973,603	941,744	508,764	354,287	52,372	26,321
Expenses										
Faculties	273,990	10,553	-	-	284,543	266,430	256,613	9,817	-	-
Academic services	62,120	3,627	-	-	65,747	57,853	54,319	3,534	-	-
Support services	133,615	6,744	-	-	140,359	134,359	128,072	6,287	-	-
Amortization and write-downs of capital assets	-	-	73,601	-	73,601	73,416	-	-	73,416	-
Capital assets	-	-	2,306	-	2,306	2,632	-	-	2,632	-
Interest on long-term debt	-	-	29,716	-	29,716	29,741	-	-	29,741	-
Loss on disposal of assets	-	-	71	-	71	-	-	-	-	-
Management fees	-	-	-	6,881	6,881	6,884	-	-	-	6,884
Withdrawal	-	-	-	-	-	2,557	-	-	-	2,557
	469,725	20,924	105,694	6,881	603,224	573,872	439,004	19,638	105,789	9,441
Services to the community	17,699	19,693	-	-	37,392	34,060	17,500	16,560	-	-
Student services	20,892	32,715	-	-	53,607	49,772	18,314	31,458	-	-
Ancillary services	45,245	197	-	-	45,442	46,092	45,900	192	-	-
Research	-	241,192	-	-	241,192	261,350	-	261,350	-	-
Total expenses	553,561	314,721	105,694	6,881	980,857	965,146	520,718	329,198	105,789	9,441
(Deficiency) excess of revenue over expenses, before the undernoted item	(8,416)	24,546	(53,176)	29,792	(7,254)	(23,402)	(11,954)	25,089	(53,417)	16,880
Unrealized gains (losses) on marketable securities (Note 10)	7,426	53,268	3,058	-	63,752	(4,572)	(778)	(4,974)	1,180	-
Excess (deficiency) of revenue over expenses	(990)	77,814	(50,118)	29,792	56,498	(27,974)	(12,732)	20,115	(52,237)	16,880
Fund balance (deficit), beginning of year	(41,375)	438,506	395,069	801,830	1,594,030	1,555,242	(24,384)	434,316	381,123	764,187
Interfund transfers (Note 6)	(15,601)	(66,267)	57	81,811	-	-	(4,259)	(15,925)	(579)	20,763
Capital expenditures financed by other funds	-	-	62,616	-	62,616	66,762	-	-	66,762	-
Fund balance (deficit), end of year	(57,966)	450,053	407,624	913,433	1,713,144	1,594,030	(41,375)	438,506	395,069	801,830

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Statement of cash flows
year ended May 31, 2007
(in thousands of dollars)

	2007	2006 (Restated Note 15)
	\$	\$
Operating activities		
Excess (deficiency) of revenue over expenses*	26,706	(44,854)
Adjustments for:		
Amortization and write-downs of capital assets	73,601	73,416
Gain on sale of marketable securities	(33,792)	(30,501)
Unrealized (gains) losses on marketable securities	(63,752)	4,572
Net change in non-cash working capital items	(6,580)	1,059
Decrease (increase) in grants and contracts related to research receivable	50,157	(4,156)
Increase in pledges receivable	(19,170)	(14,621)
	27,170	(15,085)
Investing activities		
Acquisition of capital assets	(144,221)	(111,293)
Acquisition of marketable securities, net	(22,170)	(9,103)
Proceeds from staff mortgages, net	89	666
	(166,302)	(119,730)
Financing activities		
Net change in Endowment Fund balance	29,792	16,880
Net contribution to sinking fund	(833)	(1,121)
Issuance of long-term debt	110,000	87,000
Repayment of long-term debt	(50,934)	(47,945)
Capital expenditures financed by other funds	62,616	66,762
	150,641	121,576
Net decrease (increase) in cash position	11,509	(13,239)
Cash position, beginning of year	(13,418)	(179)
Cash position, end of year	(1,909)	(13,418)
Cash position comprises:		
Short-term investments		
- Operating Fund	47,457	53,843
- Restricted Fund**	3,399	2,154
- Plant Fund	40,613	55,375
- Endowment Fund**	29,080	51,678
Bank indebtedness	(122,458)	(176,468)
	(1,909)	(13,418)

* Endowment Fund results are included in financing activities.

** These assets are subject to external restriction.

THE ROYAL INSTITUTION FOR THE ADVANCEMENT OF LEARNING / McGILL UNIVERSITY

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

1. Status and nature of activities

The Corporation with the legal name “Governors, Principal and Fellows of McGill College” (“McGill College”) was incorporated in 1821 under Royal Charter and is a university with the power of conferring degrees. The Royal Institution for the Advancement of Learning (the “Royal Institution”) was incorporated in 1802 and holds all property acquired by or transferred or bequeathed to McGill College and assumes all debt incurred by McGill College. Together these two corporations constitute the entity known as McGill University (“McGill” or the “University”). McGill’s operations include all of the activities of its teaching and research units, such as the Montreal Neurological Institute, MacDonal Campus in Ste-Anne de Bellevue, Morgan Arboretum.

McGill is a not-for-profit organization dedicated to providing post-secondary education and to conducting research and is exempt from tax under provisions of the *Income Tax Act*.

2. Significant accounting policies

McGill follows the accounting policies and practices required by the *Cahier des définitions, des termes et des directives de présentation du rapport financier annuel pour les universités du Québec* (the “Cahier”), as they are applied in the annual financial report submitted to the Ministère de l’Éducation, du Loisir et du Sport du Québec (“MELS”). These accounting policies, as applied to McGill, are in conformity with Canadian generally accepted accounting principles (“GAAP”) except for the following:

- In the course of operations, capital assets are purchased by the Operating and Restricted Funds. MELS requires that these assets be recorded as expenses of the respective fund, and capitalized and amortized in the Plant Fund. During the year, the capital assets acquired in the operating and restricted funds totaled \$62.6 million (\$66.8 million in 2006), as presented in the separate line item “capital expenditures financed by other funds”.
- As required by MELS, McGill accounts for vacation pay on a cash basis rather than on an accrual basis. Under the accrual method, the estimated vacation pay accrual would have been \$28.6 million (\$27.5 million in 2006), resulting in a decrease of \$1.1 million in the excess of revenue over expenses for the year (\$922,000 in 2006).
- The Government of Québec contributes annually to a bond sinking fund on behalf of McGill. This fund is intended for repayment of bonds at maturity and consequently MELS requires that the amount of \$42.2 million (\$41.4 million in 2006) be presented as a reduction of long-term debt.
- Employee future benefits and pension costs are expensed when paid, rather than accrued during the employee’s service. The impractical nature of determining the calculation for disclosure purposes is such that the amount was not determined as of the date of this report.

THE ROYAL INSTITUTION FOR THE ADVANCEMENT OF LEARNING / McGILL UNIVERSITY

Notes to the financial statements year ended May 31, 2007 (tabular amounts in thousands of dollars)

2. Significant accounting policies (continued)

- MELS requires that long-term government grants receivable not be discounted to a present value, as the assumption is that the “market” rate of interest for such receivables is 0%. Were these receivables discounted using the bank rate in effect at May 31, 2007, they would have been discounted by \$6.4 million (\$8.0 million in 2006), resulting in an increase of \$1.6 million in the excess of revenues over expenses in the restricted fund (decrease of \$3.5 million in 2006).
- MELS requires bond discounts to be amortized on a straight-line basis and presented as other assets as opposed to reduction of debt. The difference between the straight-line and effective interest rate method is not significant.

Had the above items been accounted for in accordance with Canadian GAAP as at May 31, 2007, the total excess (deficiency) of revenue over expenses would have increased by \$63.1 million to an excess of \$119.6 million (\$65.8 million and \$37.8 million, respectively in 2006). This amount does not include the effect of accounting for employee future benefits which has not been quantified.

Other significant accounting policies

Fund accounting

McGill follows the restricted fund method of accounting for contributions. This method involves the recording of assets, liabilities, revenue and expenses of distinct activities in separate funds.

The Operating Fund records all teaching, administrative and support activities, together with all unrestricted resources provided to McGill.

The Restricted Fund records resources which are subject to restrictions set by the external providers of the funds.

The Plant Fund records the assets, liabilities, revenue and expenses related to capital property owned and managed by McGill.

The Endowment Fund records gifts received for endowment purposes. Investment income on resources of the Endowment Fund is reported in the Operating, Restricted or Plant Fund depending on the nature of the restriction, if any, imposed by the donors. The net investment income is comprised of both the 5% investment income distribution, as well as any undistributed investment income attributable to the various funds.

Use of estimates

The preparation of financial statements 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 revenue and expenses reported in the financial statements. Actual results may ultimately differ from these estimates. In particular, significant estimates are made regarding valuation of receivables, fair values of marketable securities, estimated useful lives of capital assets, and provisions for contingencies.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

2. Significant accounting policies (continued)

Other significant accounting policies (continued)

Revenue recognition

Unrestricted contributions are recognized as revenue of the Operating Fund. Restricted contributions are recognized as revenue of the appropriate restricted fund in the year received, or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured. The majority of the pledges receivable are scheduled for receipt within five years.

Investment income earned on Restricted Endowment Fund assets is recognized as revenue of the appropriate restricted fund. Unrestricted investment income earned on Endowment Fund assets is recognized as revenue of the Operating Fund. Income earned on unexpended Plant Fund balances is recognized as revenue of the Plant Fund.

Interest and dividend revenue is recorded on an accrual basis. Realized gains or losses on sales of investments are recorded when securities are sold based on the cost. Unrealized gains and losses related to the change in market value are disclosed as a distinct line on the statement of revenues and expenses.

Tuition fees are recognized as revenue in the year during which the course sessions are held.

Government of Québec operating grants are recorded in the financial year for which they are granted. The Government of Québec grants are based on second prior year student enrolment information. The future grant amount otherwise receivable to reflect actual enrolment figures in the last two years have not been recorded.

Consolidation

The net results of not-for-profit organizations affiliated with McGill are not reported in these financial statements, as those organizations are not under the control of McGill.

Contributed services

These financial statements do not report the value of contributed volunteer hours and small gifts-in-kind, as the fair value thereof is not practicably determinable. Similarly, gifts-in-kind are not recorded unless a formal valuation to support the amount for tax receipt purposes has been made.

Short-term investments

For the purposes of the statement of cash flows, short-term investments are defined as highly liquid investments with short-term maturities.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

2. Significant accounting policies (continued)

Other significant accounting policies (continued)

Marketable securities

Marketable securities are classified as held for trading and are recorded at market value. Market value for publicly traded securities is based on quoted market values. The market value of infrequently traded securities including private equity investments, is determined based on quoted market yields, or on prices of recent transactions in the applicable securities, as appropriate. Changes in market value in the period are recorded in the statement of revenue and expenses under the caption "Unrealized gains (losses) on marketable securities".

Realized gains and losses representing sale price less original cost are presented as part of net investment income.

Derivative financial instruments

Derivative financial instruments are used as a substitute for more traditional investments. McGill holds derivative financial instruments related to the marketable securities purchased to eventually redeem the \$150 million of debentures. The instruments are recorded at their fair values. See Note 14 for details.

Student loans

Student loans are due within one year after graduation and do not bear interest. A provision is recorded for estimated uncollectible amounts.

Inventory

Inventory, including books and supplies, is valued at the lower of cost and net realizable value.

Other assets

Other assets comprise bond discounts and are amortized on a straight-line basis over the term of the bond.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

2. Significant accounting policies (continued)

Other significant accounting policies (continued)

Capital assets

Capital assets are recorded at cost. Constructed assets do not normally include interest capitalized during construction. Contributed capital assets are recorded at appraised fair value at the date of contribution when fair value can be reasonably estimated; otherwise they are recorded at a nominal amount.

Capital assets also include equipment purchased by operating funds, where the cost is to be charged against revenue in accordance with amortization schedules or other arrangements which provide for full recovery of costs over the estimated useful lives of such assets. Interest is charged on the amount outstanding based on the external cost of borrowing at the time of purchase. In exceptional cases of particular need, the internal recovery of interest costs may be waived or reduced.

Amortization of capital assets is recorded as an expense in the Plant Fund. Amortization of assets under development commences when development is completed. The amortization rate and method is prescribed by the MELS based on the estimated useful lives of various asset categories as follows:

Land improvements	Straight-line	20 years
Buildings	Declining balance	2% per year
Leasehold improvements	Straight-line	Term of lease
Equipment	Straight-line	5 to 8 years
Intangible assets*	Straight-line	5 years
Library materials	Straight-line	40 years

* Intangible assets include software licences and user licenses for electronic information resources.

Capitalization of investment income

As outlined above (revenue recognition), all investment income is attributed to a specific fund in its totality.

A portion of investment income earned on endowment fund assets is reinvested, through inter-fund transfers, to maintain the purchasing power of the original capital. Although this policy is an internal restriction, the amounts so capitalized are added to the externally restricted balances for reporting purposes.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

3. Capital assets

	2007			2006		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
	\$	\$	\$	\$	\$	\$
Land	8,110	-	8,110	8,110	-	8,110
Land improvements	3,529	1,395	2,134	3,272	1,219	2,053
Buildings	874,958	230,362	644,596	835,119	217,319	617,800
Leasehold improvements	763	431	332	763	291	472
Equipment	344,739	184,657	160,082	332,992	169,105	163,887
Library materials	205,390	42,679	162,711	191,268	37,544	153,724
Intangible assets	21,803	16,785	5,018	26,542	19,305	7,237
	1,459,292	476,309	982,983	1,398,066	444,783	953,283
Assets under development	64,172	-	64,172	22,536	-	22,536
	1,523,464	476,309	1,047,155	1,420,602	444,783	975,819

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

4. Externally restricted fund balances

	2007			
	Restricted Fund	Plant Fund	Endowment Fund	Total
	\$	\$	\$	\$
Research	370,781	-	96,473	467,254
Faculties	9,535	-	238,002	247,537
Academic services	3,708	-	21,321	25,029
Support services	7,419	8,506	14,817	30,742
Community services	38,109	-	10,767	48,876
Student services	20,501	-	195,347	215,848
Accumulated income (i)	-	-	307,976	307,976
	450,053	8,506	884,703	1,343,262

	2006 (restated)			
	Restricted Fund	Plant Fund	Endowment Fund	Total
	\$	\$	\$	\$
Research (ii)	370,649	-	86,449	457,098
Faculties	8,389	-	216,076	224,465
Academic services	3,534	-	21,116	24,650
Support services	6,818	13,053	14,855	34,726
Community services	28,735	-	11,945	40,680
Student services	20,381	-	181,083	201,464
Accumulated income (i)	-	-	243,806	243,806
	438,506	13,053	775,330	1,226,889

(i) This income is presented as externally restricted; however, as stated in Note 2 (“Capitalization of investment income”) the accumulated reinvested income is subject to internal restrictions imposed by the Board of Governors.

(ii) Refer to Note 15 for details on restatement.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

5. Internally restricted fund balances

	2007			Total
	Operating Fund	Plant Fund	Endowment Fund	
	\$	\$	\$	
Faculties	758	-	2,307	3,065
Academic services	11,605	-	2,306	13,911
Support services	19,688	(5,483)	23,075	37,280
Community services	10,504	-	976	11,480
Student services	6,074	-	66	6,140
Ancillary services	42	-	-	42
	48,671	(5,483)	28,730	71,918

	2006			Total
	Operating Fund	Plant Fund	Endowment Fund	
	\$	\$	\$	
Faculties	4,690	-	2,297	6,987
Academic services	7,442	-	2,269	9,711
Support services	14,160	(5,808)	20,881	29,233
Community services	9,498	-	990	10,488
Student services	4,439	-	63	4,502
Ancillary services	347	-	-	347
	40,576	(5,808)	26,500	61,268

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

6. Interfund transfers

	2007			
	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund
	\$	\$	\$	\$
Underdistributed income transferred (a)	(1,750)	(12,060)	-	13,810
Unrealized gains on endowment investments transferred	(7,426)	(52,112)	-	59,538
Net capitalization of income (b)	(201)	(8,148)	-	8,349
Other transfers (c)	(6,224)	6,053	57	114
	(15,601)	(66,267)	57	81,811

	2006			
	Operating Fund	Restricted Fund	Plant Fund	Endowment Fund
	\$	\$	\$	\$
Underdistributed income transferred (a)	(2,419)	(16,021)	-	18,440
Unrealized gains on endowment investments transferred	778	5,154	-	(5,932)
Net capitalization of income (b)	101	(8,106)	1,006	6,999
Other transfers (c)	(2,719)	3,048	(1,585)	1,256
	(4,259)	(15,925)	(579)	20,763

- (a) Realized investment income does not normally equal the amount determined by McGill's annual income distribution policy of 5%. Accordingly, the difference between the two is represented as either under or overdistributed income.
- (b) Represents the re-investment (i.e. capitalization) of unspent annual income distribution.
- (c) Other transfers include transfers of internally restricted funds and authorized transfers of externally restricted funds.

7. Bank indebtedness

McGill's Board of Governors has approved a maximum borrowing on short-term credit facilities of \$250 million. A maximum of \$220 million is available through unsecured lines of credit, normally drawn through bankers' acceptances for periods of up to one year. The balance is available through other individually negotiated credit facilities. The lines of credit bear interest at the prime rate, which averaged 6.0% for the year. Banker's acceptances outstanding at year end bear interest at rates ranging from 4.31% to 4.46%.

McGill manages its cash centrally in the Operating Fund. As a result, receipts and disbursements of other funds are recorded as amounts due to or from the Operating Fund. The amounts are non-interest bearing and have no fixed terms of repayment, however they are primarily working capital in nature and, accordingly, are classified as short-term.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

8. Long-term debt

	2007	2006
	\$	\$
a)		
1) Bonds (i)		
5.35% Series "4C" due June 14, 2006	-	10,593
5.55% Series "5C" due July 27, 2006	-	11,523
7.90% Series "3B" due August 2, 2006	-	3,122
8.00% Series "3B" due August 2, 2006	-	6,843
10.25% Series "LL" due November 12, 2006	-	1,000
4.75% Series "8C" due February 28, 2007	-	8,700
	-	41,781
11.50% Series "1" due January 29, 2008	4,525	4,525
5.00% Series "6C" due February 14, 2008	12,782	12,782
4.95% Series "7C" due February 15, 2008	6,039	6,039
5.05% Series "8C" due February 28, 2008	15,900	15,900
5.10% Series "8C" due February 28, 2008	11,333	11,333
5.80% Series "6B" due March 13, 2008	6,218	6,218
3.15% Series "11C" due May 27, 2008	6,726	6,726
	63,523	63,523
3.55% Series "12C" due November 24, 2008	9,395	9,395
4.70% Series "9C" due September 12, 2008	6,910	6,910
13.25% Series "II" due January 12, 2009	3,000	3,000
3.75% Series "13C" due February 24, 2009	6,510	6,510
4.55% Series "10C" due February 27, 2009	7,973	7,973
10.75% Series "3" due May 30, 2009	7,000	7,000
	40,788	40,788
5.50% Series "1C" due June 4, 2009	2,100	2,100
6.65% Series "2C" due November 26, 2009	6,575	6,575
4.00% Series "14C" due March 8, 2010	10,000	10,000
	18,675	18,675
6.20% Series "4C" due June 14, 2011	13,981	13,981
4.005 Series "12C" due November 24, 2011	5,605	5,605
5.75% Series "6C" due February 14, 2012	3,858	3,858
5.70% Series "7C" due February 15, 2012	5,358	5,358
4.10% Series "13C" due February 24, 2012	8,837	8,837
5.75% Series "8C" due February 28, 2012	5,400	5,400
5.80% Series "8C" due February 28, 2012	3,872	3,872
4.05% Series "11C" due May 27, 2012	8,571	8,571
	55,482	55,482
5.40% Series "9C" due September 12, 2012	7,405	7,405
5.30% Series "10C" due February 27, 2013	10,451	10,451
	17,856	17,856
4.50% Series "11C" due May 27, 2015	4,703	4,703
	4,653	4,653
4.40% Series "13C" due February 24, 2016	4,653	4,653
4.50% Series "14C" due March 8, 2016	7,000	7,000
	11,653	11,653
	212,680	254,461

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

8. Long-term debt (continued)

a)

2) Notes (ii)

	<u>2007</u>	<u>2006</u>
	\$	\$
4.516% due December 1, 2008	21,639	22,989
3.849% due December 1, 2009	23,284	24,297
4.059% due December 1, 2010	28,611	30,000
4.167% due December 1, 2010	4,800	5,000
4.288% due December 1, 2011	23,838	25,000
4.814% due April 25, 2012	19,200	-
4.9515% due November 1, 2012	39,753	42,376
4.355% due September 16, 2013	90,000	-
4.267% due December 1, 2015 (iii)	1,379	1,503
	252,504	151,165
	465,184	405,626
<u>Accumulated contributions to sinking fund (iv)</u>	<u>(42,217)</u>	<u>(41,384)</u>
Total Government of Québec debt, net	422,967	364,242
b) McGill Senior Debentures (v), 6.15% Series "A", due September 22, 2042	150,000	150,000
c) Royal Bank loans (vi), 5.81%, due March 19, 2014	3,228	3,594
5.17%, due June 2008	187	301
d) Other	313	325
Total long-term debt	576,695	518,462
<u>Current portion of long-term debt (vii)</u>	<u>(56,706)</u>	<u>(40,717)</u>
Long-term debt	519,989	477,745

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

8. Long-term debt (continued)

- (i) These bonds are secured by an assignment of subsidies covering principal and interest granted to McGill by the Government of Québec under Orders-in-Council. Future subsidies which secure repayment of outstanding bonds and related interest as well as approved Orders-in-Council not yet utilized by McGill are not recorded.

McGill has also made capital expenditures of \$54 million (\$99 million in 2006), currently financed through bank indebtedness, which will be financed by bonds to be issued at future dates as determined by the Government of Québec.

- (ii) These notes are secured by the Government of Québec, however as opposed to sinking fund contributions, regular interest and capital repayments are made by the Government on McGill's behalf. Interest on the notes is paid semi-annually and capital repayments are due on each note's anniversary date. Capital repayments due annually and lump sum payments due at maturity are as follows:

	<u>Annual payment</u> \$	<u>Lump sum payment</u> \$
4.516% due December 1, 2008	1,351	20,288
3.849% due December 1, 2009	1,012	21,260
4.059% due December 1, 2010	1,389	24,444
4.167% due December 1, 2010	200	4,200
4.288% due December 1, 2011	1,162	19,190
4.9515% due November 1, 2012	2,624	26,633
4.814% due April 25, 2012	800	16,000
4.355% due September 16, 2013	4,337	68,315

- (iii) These notes are secured by a grant receivable from the Ministère du Développement économique de l'innovation et de l'Exportation (MDEIE) of \$1.4 million. Semi-annual payments of capital and interest are paid by MDEIE, on the McGill's behalf, to Financement Québec.
- (iv) In 1994, the Government of Québec established a sinking fund to set aside amounts in order to repay outstanding bonds issued by certain universities. During the year, MELS contributed \$11.8 million to this fund (\$11.2 million in 2006) and applied \$11 million towards repaid bonds (\$10 million in 2006).
- (v) In September 2002, McGill issued \$150 million of unsecured debentures. Unlike MELS bonds, McGill will be required to repay these obligations from resources generated by McGill (see Note 14). Semi-annual interest payments are paid by McGill.
- (vi) The Royal Bank loans are secured by grants receivable from the Ministère des Affaires municipales et des Régions ("MAMR") and the Ministère de la Culture et des Communications ("MCC"), of \$3.2 million and \$0.2 million, respectively. Semi-annual payments of capital and interest are paid by McGill and reimbursed by both MAMR and MCC.
- (vii) The current portion of MELS bonds long-term debt totals \$63.5 million (\$41.8 million) in 2006 prior to the application of sinking fund amounts dedicated to their eventual extinguishment of \$6.8 million (\$1.1 million in 2006).

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

8. Long-term debt (continued)

Repayments of the principal due in each of the next five years (net of the accumulated contributions to the sinking fund allocated by year) are as follows:

	\$
2008	61,044
2009	64,286
2010	47,747
2011	38,172
2012	59,522

9. Employee future benefits

Pension plans

The majority of McGill's employees are members of a defined contribution pension plan (the "Plan"). Employee contributions are accumulated together with employer contributions and invested in the Plan's Accumulation Fund. Upon an employee's retirement, the accumulated amount is available for the purchase of a retirement annuity to be underwritten by a provider of the retiree's choice, including, if elected, an annuity provided by McGill. Under certain circumstances, employees in the accumulation fund are also eligible for an enhancement to their accumulated amount. For the McGill's pensions subject to defined benefits, the actuarial obligations on a going concern basis of \$1,082.8 million at July 31, 2004 under this plan are virtually fully funded by plan assets having a market value of \$1,082.2 million at July 31, 2004, with any shortfall based on the actuarial valuation to be paid by McGill.

An actuarial valuation, carried out July 31, 2004 by Eckler Partners Ltd. using the solvency method, confirmed a funding deficit of approximately \$7.8 million. Prior to December 31, 2006, the Quebec government's regulatory body required an annual contribution in order to fund the solvency deficit. Effective December 31, 2006, the regulatory body eliminated solvency valuations for universities. As a result, that amortization of the solvency deficit continued only up to December 31, 2006, totaling \$1.4 million. The total current year contribution of \$25.8 million has been recorded as the pension expense for this fiscal year (\$21.9 million in 2006).

An actuarial valuation as of December 31, 2006 is currently being conducted and is expected to be finalized in the fall of 2007.

Other plans and arrangements

McGill has a commitment to a specific group of employees who accepted early retirement settlements in 1996. These settlements entitled the employees to receive annual retirement allowance payments over their lifetime. The present value of these commitments as at May 31, 2007 is estimated at \$2.5 million (\$3 million in 2005).

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

10. Net investment income from endowments

Realized net investment income is included in the statement of revenue and expenses in the following revenue line items: net investment income, services to the community, student services net investment income, and research net investment income.

During the year, realized net investment income earned on resources held for endowment amounted to \$55.3 million and were reported in the following funds:

	<u>2007</u>	<u>2006</u>
	\$	\$
Operating Fund	7,004	4,659
Restricted Fund	48,263	54,604
	55,267	59,263

In addition, the total unrealized gain on marketable securities related to resources held for endowment amounted to \$60.7 million (\$5.8 million of unrealized loss in 2006). This was augmented by an unrealized gain of \$3.1 million (\$1.2 million loss in 2006) relating to investments purchased in the Plant Fund using the proceeds of the Debenture issue (see Note 14). Consequently, the total net unrealized gain for the year was \$63.8 million (\$4.6 million unrealized loss in 2006).

11. Financial instruments

Financial risks

McGill is subject to market risk, which is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The concentration of risk is minimized because of McGill's diversification of its investment portfolio.

The University has foreign currency risk arising from its foreign denominated cash accounts, and its holdings of foreign equities and bonds. As at May 31, 2007, McGill's foreign denominated cash and marketable securities had a market value of \$469 million.

The University has interest rate risk from the impact of interest rate changes on the McGill's cash flows and financial position.

McGill is exposed to credit risk from its debtors. A significant portion of McGill's receivables are due from governments which are believed to be at low risk of default. For the remaining receivables, the concentration of risk is minimized because of McGill's large and diverse base of counter-parties and investments.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

**Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)**

11. Financial instruments (continued)

Fair values

At May 31, 2007, the carrying values of cash and short-term investments, receivables, grants and contracts related to research receivable, bank indebtedness and accounts payable and accrued liabilities approximate their fair values.

As disclosed in Note 2, marketable securities are presented at market value.

Staff mortgages are issued at rates and terms comparable to commercial home mortgages. Their carrying value approximates fair value.

The fair value of long-term debt, excluding reductions for the sinking fund and based on rates currently available to McGill for debt with similar terms and maturities, is \$645.4 million at May 31, 2007 (\$543.4 million in 2006).

McGill has forward contracts outstanding as at May 31, 2007 to sell US\$110 million with an average forward rate of 1.2499 maturing on July 24, 2007. As at May 31, 2007, the unrealized gain on these contracts approximated \$6.3 million.

The US Dollar denominated investment outstanding, as described in Note 14 (ii), will result (at maturity) in the forfeiture of the interest receivable, in exchange for a fixed amount of proceeds. As at May 31, 2007, the fair value of the swap is \$10.8 million (\$7.7 million in 2006).

As at May 31, 2007, McGill held securities classified as non-bank asset-backed commercial paper in the Plant Fund and the restricted Fund. These securities were carried as short-term investments and had a market value of \$1 million and \$1.1 million, respectively. As a result of changes to the market conditions for this type of security, which have occurred subsequent to May 31, 2007, and which have not been resolved at the date of the audit report, the net realizable value of these securities may materially differ from their carrying value.

The marketable securities portfolio is comprised of the following types of investments:

	Endowment Fund	Restricted Fund
	%	%
Canadian Equity	24	10
US Equity	29	2
Non North American Equity	19	-
Canadian Fixed Income	27	88
US Fixed Income	1	-
	<u>100%</u>	<u>100%</u>

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

12. Commitments

Year ending May 31	Minimum lease payments
	\$
2008	1,718
2009	1,351
2010	1,247
2011	969
2012	986
Thereafter	4,215
	\$10,486

The amounts represent future minimum lease payments under existing operating leases.

Construction in progress

McGill has undertaken the construction of several new buildings, and as a result has commitments totalling \$49.4 million (\$75.5 million in 2006). These commitments are expected to be met in the normal course of operations.

Private equity funding commitments

As part of its investment activities, McGill places some of its endowment investments through private equity funds. McGill is committed to invest an additional \$50.8 million in accordance with its arrangements with these funds.

13. Contingent liabilities

Litigation

In 2002, three claims totaling \$12.85 million were instituted against McGill for bodily injuries. The plaintiffs alleged that McGill was negligent in not properly maintaining the ventilation system in a laboratory causing the plaintiffs to develop leukemia. Of these three cases, two have now been withdrawn and only one remains in the amount of \$2.3 million. McGill has filed a defense. McGill's insurers have taken a position that the claim is excluded under various clauses of the applicable insurance policies, a stand that McGill disagrees with. McGill considers that it has a solid defense against this claim but the matter is unresolved at this time. The outcome of any proceedings, and impact thereof, cannot be reasonably determined at this time. Consequently, these financial statements do not include the effect of potential outcomes.

In the normal course of its activities, McGill is party to various legal proceedings, including claims related to labour laws and the Civil Code. Although it is not possible to determine the ultimate outcome of such proceedings initiated and ongoing at May 31, 2007, management is of the opinion that they will be resolved without material effect on McGill's financial position. Any amount McGill may be required to pay will be charged to operations in the year of settlement; if the amount can be estimated and is considered likely to occur, it will be provided for in the provision for specific purposes.

In the normal course of McGill's building construction projects, various claims secured by construction hypothecs have been made by building contractors to secure payments. Such hypothecs are related to the buildings constructed or under construction.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

14. Supplementary information

Included in the assets, liabilities, and fund balance of the Plant Fund are items related to ancillary service activities financed by the proceeds of the September 2002 issuance of McGill Senior Debentures (Note 8). Details of these items are as follows:

	<u>2007</u>	<u>2006</u>
	\$	\$
Assets		
Cash and short-term investments (i)	40,613	55,375
Marketable securities, at market (ii)	28,195	25,136
Due from other funds (iii)	3,372	-
Capital assets		
Land	1,730	1,730
Buildings	73,998	71,630
Equipment	1,233	871
Bond discounts (iv)	5,891	6,058
Total assets	155,032	160,800
Liabilities		
Interest payable	1,837	1,703
Due to other funds (iii)	-	5,459
Long-term debt	150,000	150,000
Total liabilities	151,837	157,162
Fund balance		
Invested in capital assets	15,472	15,220
Internally restricted (v)	(12,277)	(11,582)
Total fund balance	3,195	3,638
Total liabilities and fund balance	155,032	160,800

- (i) Represents cash, bankers' acceptances, and treasury bills held for the purpose of future investment in revenue-generating properties.
- (ii) In October 2003, McGill entered into an agreement with RBC Dominion Securities ("RBCDS") whereby it invested in a US\$13 million denominated bond maturing in 2029. Under this agreement, the bond principal and the semi-annual interest payments due to McGill were swapped with RBCDS in exchange for RBCDS paying McGill \$85.7 million Canadian dollars in 2029. The \$28.2 million presented includes the market value of the bond and the swap agreement.

The future value of this investment, including accumulated growth to the year 2042, is expected to be sufficient to effectively redeem the \$150 million of outstanding Senior Debentures.

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

14. Supplementary information (continued)

- (iii) The amounts relate to inter-fund transactions conducted in the normal course of business. Cash settlement is expected in June 2006, which will effectively decrease overall unspent cash balance relating to the McGill Senior Debentures.
- (iv) Original bond issue costs amounted to \$6.7 million, and are being amortized on a straight-line basis over the 40-year term of the bonds. The annual amortization is approximately \$166,000.
- (v) The fund balance will increase over the years as a result of net surpluses generated from revenue-generating activities. These activities have been financed by the McGill unsecured debenture. All future surpluses will be internally restricted in order to generate a sinking fund which is intended to be used to contribute towards the repayment of the debentures maturing in September 2042, and other potential purchases of revenue-generating assets.

Included in the revenues and expenses of the Plant Fund are items related to ancillary service activities financed by the proceeds of the September 2002 issuance of McGill senior debentures (Note 8). Details of these items are as follows:

	<u>2007</u>	<u>2006</u>
	\$	\$
Revenue		
Net short-term interest income	4,947	3,914
Total revenue	4,947	3,914
Expenses		
Amortization	2,184	2,004
Interest on long-term debt	9,230	9,229
Total expenses	11,414	11,233
Deficiency of revenue over expenses	(6,467)	(7,319)
Capital costs recovered from other funds	2,422	4,477
Unrealized gains on marketable securities	3,059	1,180
Interfund transfers	543	-
Total decrease in fund balance	(443)	(1,662)

**THE ROYAL INSTITUTION FOR THE ADVANCEMENT
OF LEARNING /
McGILL UNIVERSITY**

Notes to the financial statements
year ended May 31, 2007
(tabular amounts in thousands of dollars)

15. Restatement of comparative year

The 2006 financial statements have been restated because, in the prior year, the long-term pledges receivable were not discounted to their present value as required by the accounting standards for financial instruments. As a result of these changes, long-term pledges receivable in the restricted fund have been discounted to their present value. The effect of this change is to reduce the opening restricted fund balance of the 2006 financial statements by \$1.1 million and to reduce restricted revenue related to the increase in pledges in that year by \$1.8 million.

	As previously reported	Adjustment	As restated
	\$	\$	\$
Opening fund balance	435,459	(1,143)	434,316
Excess of revenue over expenses	21,941	(1,826)	20,115
Interfund transfers	(15,925)	-	(15,925)
Fund balance, end of year	441,475	(2,969)	438,506

16. Comparative figures

Certain comparative figures for the year ended May 31, 2006 have been reclassified in order to conform to the presentation adopted in the current year.