

Financial Statements of

**MICHAEL SMITH FOUNDATION FOR
HEALTH RESEARCH**

Years ended March 31, 2006 and 2005



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AUDITORS' REPORT

To the Members of the
Michael Smith Foundation for Health Research

We have audited the statement of financial position of Michael Smith Foundation for Health Research as at March 31, 2006 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Foundation'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 Foundation as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the Society Act (British Columbia), we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Chartered Accountants

Vancouver, Canada

May 9, 2006

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Statements of Financial Position

March 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash	\$ 114,680,575	\$ 40,594,254
Accounts receivable	8,225,033	32,716,810
Short-term investments (note 3)	27,914,140	25,296,029
Prepaid expenses and deposits	26,954	22,314
	<u>150,846,702</u>	<u>98,629,407</u>
Long-term investments (note 3)	12,430,342	18,655,976
Endowment funds (note 3)	2,233,539	2,233,539
Capital assets (note 4)	809,029	832,659
	<u>\$ 166,319,612</u>	<u>\$ 120,351,581</u>

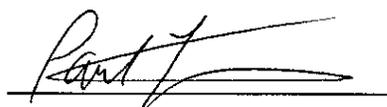
Liabilities and Net Assets

Current liabilities:		
Accounts payable and accrued liabilities	\$ 851,138	\$ 893,483
Grants payable	594,179	862,057
Current portion of obligations under capital lease (note 5)	40,914	36,018
	<u>1,486,231</u>	<u>1,791,558</u>
Obligations under capital lease (note 5)	18,649	59,563
Deferred contributions (note 6):		
Contributions for expenses of future periods	138,773,201	96,694,291
Capital contributions	809,029	832,659
Restricted projects	22,998,963	18,739,971
	<u>162,581,193</u>	<u>116,266,921</u>
Net assets:		
Restricted for endowment purposes	2,233,539	2,233,539
	<u>\$ 166,319,612</u>	<u>\$ 120,351,581</u>

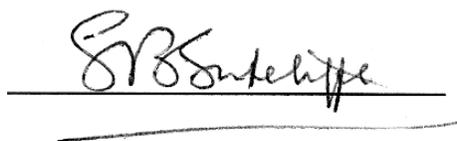
Commitments (note 7)

See accompanying notes to financial statements.

Approved on behalf of the Foundation:



Director



Director

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Statements of Operations

Years ended March 31, 2006 and 2005

	Year ended March 31, 2006	Year ended March 31, 2005
Revenue:		
Amortization of deferred contributions (note 6(a))	\$ 30,986,871	\$ 27,137,157
Amortization of deferred capital contributions (note 6(b))	411,365	284,786
Restricted projects (note 6(c))	3,774,008	2,227,437
Other	342,182	386,249
	<u>35,514,426</u>	<u>30,035,629</u>
Expenses:		
Grants and awards:		
Career	11,857,522	10,721,369
Trainee	3,991,320	3,428,154
Canadian Institute for Health Research training centres	68,750	75,000
British Columbia Health Research Foundation scholars and trainees	-	13,680
Research Institutions	3,747,795	3,747,795
Research Units	4,563,582	4,029,482
Research Networks	1,906,759	663,350
Other grants-in-aid	42,000	210,000
Program development and delivery	1,261,092	1,392,040
Coordination, research and analysis	303,286	437,648
Restricted project expenses (note 6(c))	3,774,008	2,230,433
	<u>31,516,114</u>	<u>26,948,951</u>
Administration:		
General operating	2,428,697	2,443,540
Information services	1,158,250	358,352
Amortization of capital assets	411,365	284,786
	<u>3,998,312</u>	<u>3,086,678</u>
	<u>35,514,426</u>	<u>30,035,629</u>
Excess of revenue over expenses	\$ -	\$ -

See accompanying notes to financial statements.

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Statements of Cash Flows

Years ended March 31, 2006 and 2005

	Year ended March 31, 2006	Year ended March 31, 2005
Cash flows from operating activities:		
Contributions from the Province of British Columbia		
- operations	\$ 100,000,000	\$ -
Contributions from the Province of British Columbia		
- Restricted projects	2,500,000	-
Contributions from the Other Provinces - Restricted projects	33,000	-
Grants and awards	(26,238,704)	(22,653,562)
Program development, delivery and administration	(4,928,577)	(4,722,100)
Restricted project expenses	(4,251,366)	(1,817,611)
Other revenue	342,182	386,249
Investment revenue	3,446,016	3,347,504
	<u>70,902,551</u>	<u>(25,459,520)</u>
Cash flows from investing activities:		
Change in investments	3,607,523	25,072,923
Purchase of capital assets	(387,735)	(235,543)
	<u>3,219,788</u>	<u>24,837,380</u>
	<u>74,122,339</u>	<u>(622,140)</u>
Cash flows from financing activities:		
Payments on change in obligations under capital lease	(36,018)	95,582
Increase (decrease) in cash	74,086,321	(526,558)
Cash, beginning of year	40,594,254	41,120,812
Cash, end of year	<u>\$ 114,680,575</u>	<u>\$ 40,594,254</u>

See accompanying notes to financial statements.

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

1. Nature of operations:

The Michael Smith Foundation for Health Research (the "Foundation") is incorporated under the Society Act (British Columbia) and is a registered charity under the Income Tax Act (the "Act"). Accordingly the Foundation is exempt from income and capital taxes and is able to issue donation receipts for income tax purposes.

The Foundation was established to create a vibrant and sustainable British Columbian health research environment that is recognized for excellence and:

- has the human resources, infrastructure and research space to compete effectively for national and international funding across all sectors;
- anticipates and responds to B.C. health needs;
- builds the B.C. economy; and
- networks for critical mass across Western Canada, nationally and internationally.

At its inception, the Foundation received a \$110 million grant from the Province of British Columbia based on the vision included in a comprehensive plan developed by a coalition representing the broad health research community in British Columbia. In February 2005 the Province of British Columbia announced an additional grant of \$100 million, of which the Foundation received \$30 million in 2005 and \$70 million in 2006. Each year the Foundation conducts a range of peer-reviewed grant programs and projects that draw down on these funds. The Foundation also receives additional funding from the Province of British Columbia and other sources to undertake various projects consistent with its purpose. In 2006, the Province of British Columbia provided new funding of \$8 million to the Foundation to support broad health services research related to the Nursing Workforce and associated policy initiatives.

2. Significant accounting policies:

(a) Basis of accounting:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles for not-for-profit organizations. The Foundation follows the deferral method of accounting for contributions that include grants, donations and service contracts from other sources.

(b) Capital assets:

Capital assets are recorded at cost less accumulated amortization. Assets acquired under capital leases are recorded at cost and amortized over the estimated life of the assets or over the lease term, as appropriate. Repair and maintenance costs are charged to expense. Leasehold improvements are amortized on a straight-line basis over the term of the lease. Other capital assets are amortized on a straight-line basis over their estimated useful life at the following annual rates:

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

2. Significant accounting policies (continued):

(b) Capital assets (continued):

Asset	Rate
Furniture	20%
Office equipment	20%
Computer equipment	30%
Computer software	100%

(c) Leases:

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risks of ownership to the Foundation. Assets acquired under capital leases are amortized at the rates as described in note 2(b). Obligations recorded under capital leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to expense.

(d) Short-term investments:

Short-term investments include term deposits, treasury bills, banker's acceptances, bonds, and commercial paper with a term to maturity of less than one year, and are carried at the lower of amortized cost based on their maturity dates and market value.

(e) Long-term investments:

Long-term investments include term deposits, treasury bills, banker's acceptances, bonds, commercial paper, and securities with a term to maturity of more than one year, and are carried at cost less provision for declines in market value that are other than temporary.

(f) Revenue recognition:

In March 2001, the provincial government of British Columbia provided a grant of \$110 million to establish the Foundation and implement a five year strategic plan. In February 2005 the Province of British Columbia announced an additional grant of \$100 million for the Foundation of which \$30,000,000 was received in 2005 and \$70,000,000 was received in 2006. Under the terms of the Foundation's bylaws, this funding, along with the future investment income, will be directed to the granting of funds to eligible recipients and the payment of the Foundation's operating and capital expenditures. This restricted contribution, along with any additional related grants and the investment income thereon, are deferred and recognized as revenue in the year in which the related expenses are incurred by the Foundation. Restricted contributions applied toward the purchase of capital assets are deferred and amortized to revenue, at a rate corresponding with the amortization rate for the related capital assets.

The Foundation also receives various other restricted contributions through project grants, contracts or matching contributions from other organizations that are deferred and recognized as revenue in the year in which the related expenses are incurred by the Foundation.

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

2. Significant accounting policies (continued):

(f) Revenue recognition (continued):

Endowment contributions are recorded as a direct increase in net assets. Investment income earned on endowment contributions are deferred and recognized as revenue in the year in which the related expenses are incurred by the Foundation.

From time to time the Foundation's Board of Directors may place internal restrictions on certain endowments or other resources such that the resources are available only for the specified purpose.

Unrestricted contributions are recognized as revenue in the current period if the amount to be received can be reasonably estimated and collection is reasonably assured. Unrestricted investment and other incomes are recognized as revenue when earned.

(g) Grants and awards:

Grants and awards approved by the Foundation are recorded as expenses in the fiscal year that the payment is to be made. Amounts are usually paid in quarterly installments in advance.

(h) Volunteer services:

The Foundation gratefully acknowledges the significant contribution it receives in the form of services from a large number of volunteer peer reviewers, committee members and task force participants. Such services, while essential to the Foundation's operations, are not recorded in these financial statements because of the difficulty of determining a particular value to them.

(i) Lease inducement:

Cash payments received as lease inducements by the Foundation under the terms of the lease for office premises are being amortized to income through a reduction of rental expense over the term of the lease. The unamortized balance of \$170,708 (2005 - \$187,803) has been included in accounts payable and accrued liabilities.

(j) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(k) Comparative figures:

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

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

3. Investments:

	2006		2005	
	Book value	Market value	Book value	Market value
Bonds, treasury bills and bankers' acceptances	\$ 31,560,584	\$ 31,574,649	\$ 45,003,310	\$ 45,489,538
Equities	11,017,437	12,534,996	1,182,234	1,361,721
Total investments	42,578,021	44,109,645	46,185,544	46,851,259
Short-term	27,914,140	27,939,638	25,296,029	25,463,060
Endowment funds	2,233,539	2,629,503	2,233,539	2,416,662
Long-term	\$ 12,430,342	\$ 13,540,504	\$ 18,655,976	\$ 18,971,537

Investments in bonds, treasury bills and bankers' acceptances have maturity dates ranging from fiscal 2007 to fiscal 2013.

4. Capital assets:

2006	Cost	Accumulated amortization	Net book value
Computer software	\$ 402,576	\$ 286,094	\$ 116,482
Computer hardware	398,671	256,240	142,431
Office furniture	501,721	332,235	169,486
Leasehold improvements	507,839	190,894	316,945
	1,810,807	1,065,463	745,344
Equipment under capital lease	115,791	52,106	63,685
	\$ 1,926,598	\$ 1,117,569	\$ 809,029

2005	Cost	Accumulated amortization	Net book value
Computer software	\$ 169,612	\$ 143,164	\$ 26,448
Computer hardware	307,946	167,266	140,680
Office furniture	437,674	238,295	199,379
Leasehold improvements	507,839	140,110	367,729
	1,423,071	688,835	734,236
Equipment under capital lease	115,792	17,369	98,423
	\$ 1,538,863	\$ 706,204	\$ 832,659

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

5. Obligations under capital lease:

Capital lease payments for the years ending March 31 are as follows:

	2006	2005
2006	\$ -	\$ 45,232
2007	45,697	45,697
2008	19,193	19,193
Total minimum lease payments	64,890	110,122
Less amount representing interest	(5,327)	(14,541)
Present value of minimum lease payments	59,563	95,581
Current portion of obligations under capital lease	(40,914)	(36,018)
	\$ 18,649	\$ 59,563

6. Deferred contributions:

Deferred contributions represent unspent grants or contract resources restricted for specific purposes and restricted projects, and include expenses for operating as well as capital purposes.

(a) Deferred contributions relating to expenses of future periods:

	2006	2005
Balance, beginning of year	\$ 96,694,291	\$ 90,591,173
Contributions received during the year:		
Grant from Province of British Columbia	70,000,000	30,000,000
Investment income earned during the year	3,446,016	3,347,504
Amounts reclassified from accrued liabilities	7,500	128,314
	170,147,807	124,066,991
Amounts recognized as revenue during the period	(30,986,871)	(27,137,157)
Amounts applied toward capital assets purchased during the period	(387,735)	(235,543)
Balance, end of year	\$ 138,773,201	\$ 96,694,291

In early 2005, the Province of British Columbia announced an additional grant of \$100 million for the Foundation of which \$30,000,000 was receivable in 2005 and the remaining \$70,000,000 was received in 2006 to be used to fund ongoing operations and programs.

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

6. Deferred contributions (continued):

(b) Deferred contributions relating to capital assets:

	2006	2005
Balance, beginning of year	\$ 832,659	\$ 881,902
Allocation of deferred contributions - operations (note 6(a))	387,735	235,543
Amounts amortized to revenue	(411,365)	(284,786)
Balance, end of year	\$ 809,029	\$ 832,659

(c) Deferred contributions relating to restricted projects:

	2006	2005
Balance, beginning of year	\$ 18,739,971	\$ 18,467,408
Restricted project - Province of British Columbia - Children and Youth with Special Needs	-	2,500,000
Restricted project - Province of British Columbia - Nursing workforce	8,000,000	-
Restricted project - Other Provinces - Children and Youth with Special Needs	33,000	-
	26,772,971	20,967,408
Amounts amortized to revenue	(3,774,008)	(2,227,437)
Balance, end of year	\$ 22,998,963	\$ 18,739,971

The Restricted Project funds receivable from the Province of British Columbia in 2005 consisted of - Children and Youth with Special Needs - \$2,500,000. In 2006, the Province of British Columbia provided \$8,000,000 to the Foundation to support broad health services research related to the Nursing Workforce and associated policy initiatives. The Foundation also received a total of \$33,000 in contributions to the Children and Youth with Special Needs consensus research conference from the governments of Nova Scotia, Northwest Territories, Ontario and Saskatchewan.

The balance of deferred contributions for restricted contributions is comprised of the following:

	2006	2005
Health Services and Policy Research Support Network	\$ 12,819,998	\$ 15,457,358
SARS Accelerated Vaccine Initiative	505,802	782,613
Children and Youth with Special Needs	1,673,163	2,500,000
Nursing workforce and associated policy initiatives	8,000,000	-
	\$ 22,998,963	\$ 18,739,971

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

7. Commitments:

(a) Grant commitments:

Through a variety of targeted granting programs, the Foundation commits the majority of its funds to providing peer-reviewed research awards aimed at fulfilling the Foundation's mandate. Many of the commitments made through these granting programs have terms that span more than one fiscal year. Grant commitments become payable in the period that the payment is to be made.

The following table summarizes grant commitments approved by the Foundation, by major grant program.

Grant Program	Grant commitments for the years ending March 31			Total
	2007	2008	2009 and thereafter	
Career	\$ 10,964,377	\$ 6,664,469	\$ 5,189,583	\$ 22,818,429
Trainee	3,133,378	1,138,239	127,125	4,398,742
Research Institutions	3,747,795	936,950	-	4,684,745
Research Units	4,413,582	2,255,407	384,004	7,052,993
Research Networks	2,187,500	3,500,000	2,625,000	8,312,500
	\$ 24,446,632	\$ 14,495,065	\$ 8,325,712	\$ 47,267,409

(b) Grant commitments - Restricted Projects:

Through a variety of specialized granting programs, the Foundation also may commit significant amounts of Restricted Project funding to providing peer-reviewed research awards aimed at fulfilling each Project's specific mandate. Some of the commitments made through these granting programs have terms that span more than one fiscal year.

The following table summarizes grant commitments approved by the Foundation, by Restricted Project:

Restricted Projects	Grant commitments for the years ending March 31			Total
	2007	2008	2009 and thereafter	
Health Services and Policy				
Research Support Network				
- Capacity Building	\$ 881,250	\$ -	\$ -	\$ 881,250
- Investigative Teams	748,982	748,982	374,491	1,872,455
- Operating Grants	349,850	174,850	-	524,700
	\$ 1,980,082	\$ 923,832	\$ 374,491	\$ 3,278,405
SARS Accelerated				
Vaccine Initiative				
- Operating Grants	\$ 470,000	\$ -	\$ -	\$ 470,000

MICHAEL SMITH FOUNDATION FOR HEALTH RESEARCH

Notes to Financial Statements

Years ended March 31, 2006 and 2005

7. Commitments (continued):

(c) Office space and equipment lease commitments:

The Foundation rents office space under a long-term lease, which expires July 31, 2011 and provides for an additional five year extension at the option of the Foundation.

The Foundation also leases various office equipment.

The Foundation has future minimum lease payments under operating leases as follows:

Years ending March 31:

2007	\$ 376,752
2008	371,232
2009	365,137
2010	359,169
2011 and thereafter	474,913
	<hr/>
	\$ 1,947,203

8. Related party transactions:

On July 11, 2002, British Columbia Order in Council - Deregulation Statutes Amendment Act (No. 2) 2002, was approved by the Province of British Columbia. This Order dissolved the British Columbia Health Research Foundation ("BCHRF") and transferred all of the assets and liabilities of BCHRF to the Foundation.

The Foundation agreed to assume responsibility for the costs associated with any renewal of the BCHRF's existing scholar and trainee awards. This amount is included in the expenses of the Foundation for 2005.

9. Financial instruments:

The Foundation's financial instruments consist of cash and cash equivalents, accounts receivable, short-term investments, long-term investments, accounts payable and accrued liabilities, and grants payable. The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and grants payable approximates their carrying value. The fair value of short-term investments and long-term investments is disclosed in note 3. Unless otherwise noted, it is management's opinion that the Foundation is not exposed to significant interest rate, currency or credit risks from these financial instruments.