

The Hospital for Sick Children
Financial Position and Management for the year ended March 31, 2010

The following is management's commentary on the results of operations for The Hospital for Sick Children (SickKids or the Hospital) for the year ended March 31, 2010 and its financial position as at March 31, 2010. This commentary should be read in conjunction with the Hospital's audited financial statements.

SickKids' financial statements are prepared according to Canadian Generally Accepted Accounting Principles (GAAP) and include the assets, liabilities, cash flows and operations of the Hospital, which encompasses patient care, research and education. They do not include the activities or assets of SickKids Foundation, The Women's Auxiliary of the Hospital for Sick Children, The Hospital for Sick Children Employee Pension Plan, or substantially all costs related to physicians. SickKids is a registered charity under the Income Tax Act (Canada) and, as such, is exempt from income taxes.

The following table summarizes selected data from the Hospital's statement of operations and balance sheet for the years ended March 31, 2010 and 2009:

| <u>Fiscal Years Ended March 31</u> (in thousands of dollars) | <u>2010</u> | <u>2009</u> |
|--|--------------------|--------------------|
| | \$ | \$ |
| REVENUE | | |
| Ministry of Health and Long-Term Care / Toronto Central Local Health Integration Network | 421,930 | 413,943 |
| Patient care and other | 67,483 | 53,972 |
| Research grants..... | 132,904 | 127,795 |
| Commercial services | 35,729 | 35,284 |
| Amortization of deferred capital contributions | <u>24,247</u> | <u>23,094</u> |
| | 682,293 | 654,088 |
| EXPENSES | | |
| Salaries and benefits..... | 424,487 | 427,813 |
| Other expenses | <u>250,132</u> | <u>232,261</u> |
| | 674,619 | 660,074 |
| Excess (deficiency) of revenue over expenses before investment income (loss) | <u>7,674</u> | <u>(5,986)</u> |
| Investment income (loss)..... | <u>33,895</u> | <u>(13,790)</u> |
| Excess (deficiency) of revenue over expenses | <u>41,569</u> | <u>(19,776)</u> |
| ASSETS | | |
| Current | | |
| Appropriated cash and cash equivalents..... | 80,431 | 72,350 |
| Accounts receivable..... | 56,510 | 46,083 |
| Short-term investments..... | 63,556 | 69,927 |
| Other current assets | <u>12,567</u> | <u>12,641</u> |
| Total current assets | <u>213,064</u> | <u>201,001</u> |
| Long-term investments..... | 274,101 | 76,174 |
| Capital assets, net | 382,225 | 373,217 |
| Accrued pension benefits | <u>32,287</u> | <u>24,638</u> |
| Total assets | <u>901,677</u> | <u>675,030</u> |
| LIABILITIES AND EQUITY | | |
| Current | | |
| Bank indebtedness..... | 51,539 | 63,394 |
| Accounts payable and accrued liabilities | 94,455 | 107,294 |
| Current portion of long-term liabilities..... | 4,378 | 4,183 |
| Amounts held for other organizations..... | 30,642 | 22,320 |
| Deferred contributions | <u>113,345</u> | <u>119,957</u> |
| Total current liabilities | <u>294,359</u> | <u>317,148</u> |
| Deferred capital contributions..... | 231,538 | 230,861 |
| Long-term debt | 200,382 | 437 |
| Pension and other post-employment benefits..... | <u>110,220</u> | <u>102,600</u> |
| Total liabilities | <u>836,499</u> | <u>651,046</u> |
| Equity | <u>65,178</u> | <u>23,984</u> |
| Total liabilities and equity | <u>901,677</u> | <u>675,030</u> |

Revenues

For the year ended March 31, 2010, SickKids reported revenues of \$682.3 million, excluding investment income. This represents an increase of \$28.2 million or 4.3% over 2008/09. At \$421.9 million, funding from the Ministry of Health and Long-Term Care (MOHLTC) and the Toronto Central Local Health Integration Network (TC LHIN) is SickKids' most significant source of income, representing 61.8% of total revenues and an increase of \$8.0 million or 1.9% compared to the prior year. A global base funding increase of 2.1% was provided in 2009/10 and \$15.5 million in new base or one-time funding was awarded for initiatives such as reducing surgical and MRI wait times, relieving areas of systemic clinical pressure including bone marrow and solid organ transplant and hiring new graduate nurses. This compares to \$14.5 million one-time funding in the previous year.

Patient Care and Other Revenues totaled \$67.5 million in 2009/10, an increase of \$13.5 million or 25.0% over 2008/09. Due, in part, to the specialized hospital services available at SickKids, the Hospital generates substantial revenue from the provision of services to patients from outside of Ontario. In 2009/10, \$8.6 million was generated for out-of-province patients and \$4.3 million for international patients. Out-of-province revenue is governed by an inter-provincial agreement that prescribes standard per diem rates, as well as fixed rates for select high cost procedures. International patient revenue is primarily generated from insurance companies, private payers and humanitarian grants. During the year, SickKids recorded \$6.1 million in federal funding from Citizenship & Immigration Canada for employee training and the translation of materials to ease the transition of new immigrants into Canada's health-care system. Other revenue in this category includes agency and other government grants, foundation grants, external research, laboratory and diagnostic billings and dentistry professional fees.

Research grants recorded as revenue grew by \$5.1 million, or 4.0%, in 2009/10 to \$132.9 million. This includes support for both research operations and infrastructure. The major sources of research operating funding include the Canadian Institutes of Health Research, the National Institutes for Health Research and the Canadian Cancer Society. Infrastructure support received from agencies such as Canada Foundation for Innovation, Genome Canada/Ontario Genomics Institute and the Ontario Research Fund has been a major source of funding for research equipment and facilities. SickKids Foundation also contributes substantially towards research infrastructure costs.

Commercial services have successfully continued to contribute to research and patient care initiatives within the Hospital. Revenues increased \$0.4 million or 1.3%, due to an increase in parking and rental income, offset by a reduction in retail operations and international consulting revenue. A significant portion of total annual revenue is generated from parking lots operated by the Hospital. The Specialty Food Shop, Shoppers Drug Mart and Tim Horton's also represent major sources of funding. Other sources of income from commercial activities include rental income from a property owned by SickKids to house visiting physicians and fellows, rental income from leased retail space and gift/clothing shops.

Expenses

Salaries and benefits represent the most significant operating expense at SickKids. These costs amounted to \$424.5 million in 2009/10, representing 62.9% of total expenses. Salaries and benefits decreased \$3.3 million or 0.8% compared to 2008/09 as a result of an unusual decline in pension expense. The 2009/10 pension expense was reduced by \$16.1 million due to an increase in interest rates as at December 31, 2008 that are used in the actuarial determination of pension liabilities. Incremental staff funded by one-time programs and annual compensation increases mostly offset the reduction in pension expense. In light of uncertainty related to the outlook for financial markets and future increases in government funding, the Hospital instituted a freeze in base salaries for Director and Executive-level employees during the regular annual compensation cycle in the fall of 2009.

Other expenses increased \$17.9 million or 7.7% over 2009/10 driven by depreciation, debenture-related costs and clinical and research activity levels. Included in other expenses are medical, laboratory and drug supplies, building maintenance, administration and other operating costs, interest and depreciation expense.

Operating Performance

For the year ended March 31, 2010, the Hospital reported a surplus of \$41.6 million. This surplus includes the benefit of the unusual decline in pension expense, as well as significant realized and unrealized investment gains. From an operational standpoint, excluding the impact of pension, investment gains and net building depreciation, the Hospital achieved a balanced budget again in 2009/10 and continues to demonstrate sound fiscal management in meeting its commitments to the MOHLTC and the TC LHIN, as outlined in the Hospital Service Accountability Agreement (H-SAA). The H-SAA is a legal agreement between the Hospital and the TC LHIN which establishes standards, targets and measures to monitor the performance of hospital services delivered by SickKids.

Financial Position

As of March 31, 2010, SickKids held investments and appropriated cash and cash equivalents totaling \$418.1 million. Bank indebtedness, long-term debt and amounts held for others and for certain deferred contributions amounted to \$304.3 million, leaving \$113.8 million in net liquidity. Short-term investments, together with appropriated cash and cash equivalents, primarily represent funds that have been received by the Hospital for specific purposes, but have not yet been spent. These funds are from research granting agencies and other external sources and also include amounts held for other organizations. Long-term investments are funds that cover certain long-term obligations of the Hospital, mainly supplemental pension obligations and unspent proceeds on long-term debt.

On December 16, 2009, the Hospital issued Series A Senior Unsecured Debentures (the Debentures) in the amount of \$200 million. The proceeds of this issuance will be used to finance a portion of the capital costs of a new building (the Research & Learning Tower), which will house the SickKids Research Institute, a division of the Hospital, and provide facilities for inter-professional training and learning programs.

At March 31, 2010, SickKids had two demand operating lines of credit totaling \$125 million. As at March 31, 2010, the Hospital had utilized \$51.5 million of the operating lines, compared to \$63.4 million in the prior year. The decrease in bank indebtedness is primarily attributable to the 2009/10 operating surplus and decreased capital spending, partly offset by an increase in working capital.

As at March 31, 2010, the Hospital was in compliance with all covenants associated with the Debentures and the operating lines of credit.

\$382.2 million in net capital assets is comprised of unencumbered property, medical and other equipment and land. As at March 31, 2010, capital assets have been funded by \$231.5 million in deferred capital grants, received from SickKids Foundation, government and other granting agencies.

Pension Plan

The vast majority of employees at SickKids participate in a defined benefit pension plan with a small component in a defined contribution plan. The financial management of the pension fund falls under the stewardship of the Investment and Pension Committee of the Board of Trustees, which has achieved a historical long-term investment performance consistently above industry benchmarks. From March 31, 1995 to December 31, 2009, the annual rate of return for the pension fund has been 10.8%, which ranks in the 1st percentile relative to large Canadian Pension Funds (the Universe of RBC Dexia Pension Plans over \$250 million). As a result of this top decile investment performance over many years, the SickKids' pension and other post-employment benefit plans are currently in sound financial condition, reporting a significant surplus using all bases of valuation (Accounting, Going Concern and Solvency).

Some employees are also entitled to benefits under an unfunded supplemental defined benefit pension plan. Although this plan cannot be funded in a tax effective manner, SickKids has acknowledged this future obligation of \$109.9 million by setting aside investments valued at \$90.3 million as of March 31, 2010. Particularly while the registered plan remains in a surplus position, SickKids' plan is to continue to grow this investment fund.

Support From SickKids Foundation

Philanthropy is a critical source of funding for SickKids and is separate and distinct from the funding received from government and granting agencies. Philanthropy, which includes private donations from individuals, families, corporations and foundations, enables SickKids to make needed investments in care, education and research. It allows SickKids to continue to be a world-class institution.

Financial support from SickKids Foundation totaled \$47.9 million in 2009/10. A significant portion of this amount was directed towards research infrastructure support. SickKids Foundation also contributed to several key patient care initiatives, including the reconfiguration of the Emergency Department and renovation of the Haematology/Oncology Ambulatory clinic. The balance of funding was used to purchase medical equipment, to provide education and training to health-care professionals and to fund various special programs aimed at enhancing child and family-centered care.

Concurrent with the issuance of the Debentures, the Hospital entered into two funding agreements with SickKids Foundation, the Research Tower Funding Agreement and the Core Funding Agreement.

The Research Tower Funding Agreement provides that SickKids Foundation will conduct a capital fundraising campaign in respect of the Research & Learning Tower and will provide, on a best efforts basis, certain grants to the Hospital in respect of the Research & Learning Tower. In general, SickKids Foundation's grants under the Research Tower Funding Agreement will take precedence over any other commitments of SickKids Foundation to the Hospital. The Hospital will use a portion of the grants toward the design and construction costs of the Research & Learning Tower and a portion to support the Hospital's interest and principal obligations related to the Debentures. Subject to certain provisions for termination, the Research Tower Funding Agreement will remain in effect for as long as any Debentures are outstanding. As at March 31, 2010, accounts receivable included an amount due from SickKids Foundation of \$2.5 million, which includes a \$2.2 million grant to offset net interest expense related to the Debentures.

The Core Funding Agreement provides for the terms and conditions under which SickKids Foundation will make grants to the Hospital in respect of core funding support for the SickKids Research Institute and certain other matters, including grants intended to fund the operating and maintenance costs of the Research & Learning Tower.

Each of the Research Tower Funding Agreement and the Core Funding Agreement contains a provision which provides for mandatory renegotiation if the Board Unrestricted Endowment of SickKids Foundation falls below \$70 million. The Board Unrestricted Endowment of SickKids Foundation represents unrestricted resources transferred by the Board of Directors of SickKids Foundation to the Foundation's Endowment Fund. As at March 31, 2010, SickKids Foundation held \$148.8 million in Board Unrestricted Endowments.