# Finance

# Annual Report 2004-05

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# PREFACE

## Public Accounts 2004-05

The Public Accounts of Alberta are prepared in accordance with the *Financial Administration Act* and the *Government Accountability Act*. The Public Accounts consist of the annual report of the Government of Alberta and the annual reports of each of the 24 Ministries.

The annual report of the Government of Alberta released June 29, 2005 contains the Minister of Finance's accountability statement, the consolidated financial statements of the Province and a comparison of the actual performance results to desired results set out in the government's business plan, including the Measuring Up report.

On November 24, 2004 the Ministry of Finance became responsible for the responsibilities of the former Ministry of Revenue. This annual report contains reporting information for the Ministry of Finance and contains the Minister's accountability statement, the audited consolidated financial statements of the Ministry and a comparison of actual performance results to desired results set out in the ministry business plan.

This Ministry annual report also includes:

- the financial statements of entities making up the Ministry including the Department of Finance, regulated funds, provincial agencies and Crown-controlled corporations for which the Minister is responsible,
- other financial information as required by the *Financial Administration Act* and *Government Accountability Act*, either as separate reports or as a part of the financial statements, to the extent that the Ministry has anything to report, and
- financial information relating to trust funds.

# MINISTER'S ACCOUNTABILITY STATEMENT

The Ministry's Annual Report for the year ended March 31, 2005, was prepared under my direction in accordance with the *Government Accountability Act* and the government's accounting policies. All of the government's policy decisions as at September 22, 2005 with material economic or fiscal implications of which I am aware have been considered in the preparation of this report.

*[Original Signed]*

Honourable Shirley McClellan
Minister of Finance
September 22, 2005

# MESSAGE FROM THE MINISTER

Looking back at 2004-05, it was truly a remarkable year in Alberta's history. Strong resource revenue allowed the province to pay off its remaining accumulated debt. Albertans deserve much of the credit for such an accomplishment. They told us time and again to get our fiscal house in order and pay down the debt that once amounted to almost $23 billion.

Albertans also played a key role in shaping the Province's fiscal future by completing the *It's Your Future* survey. After counting and analyzing a record number of responses, it came as no real surprise that health care and education topped the list. Our budget numbers reflected the government's commitment to those areas.

Alberta's strong fiscal position was once again recognized by international bond rating agencies. For the fourth consecutive year, Dominion Bond Rating Service, Moody's Investor Service, and Standard and Poors rated our province as triple A. We are the only Province in Canada with such status.

The government's fiscal framework continued to protect programs from the volatility that comes with non-renewable resource revenue. For 2004-05, the limit on resource revenue spending was increased to $4 billion. The additional dollars were primarily used in health and education.

The Sustainability Fund, created in 2003-04 to protect spending from volatile revenue and the cost of emergencies and disasters again proved to be a valuable resource for Albertans in need. The Fund provided almost $1 billion for BSE assistance, flood assistance, wildfire costs, and natural gas rebates in fiscal 2004-05. We also balanced our budget for the eleventh straight year.

Albertans can once again proudly state they pay the lowest overall taxes in Canada. In 2004, the government reduced the business tax rate, continued indexation of the personal income tax system and for the eleventh straight year school property tax rates have been frozen. The combination of low personal and corporate taxes translates into a competitive tax system that is helping to attract workers and investments to Alberta, creating a strong and vibrant economy.

Reforms to auto insurance continued to be a focal point with the implementation of a new system last October. We launched an awareness campaign designed to steer Alberta drivers through the many facets of the reforms that achieve our goal of fair and affordable rates.

With pension plans on the minds of many, changes were made so members of private sector pensions can now keep better tabs on their plans. Increasing transparency and accountability means more access to financial information. Albertans are in a better position to monitor their own pensions long before they need them. The Superintendent of Pensions now has more effective ways of monitoring the funding of pension plans and stronger enforcement powers if problems arise.

It was another strong year for the Heritage Fund which earned $1.1 billion from its investments, capital projects, health care, education, roads and tax reductions.

Working with the Alberta Hotel and Lodging Association, the hotel room tax was changed to a tourism levy and the rate was reduced from five to four per cent. As a result, the tourism industry will see increased funds to better encourage more travellers to take an Alberta break.

History was made with the signing of a provincial/territorial Memorandum of Understanding regarding securities regulation. This is the first step towards streamlining and simplifying securities laws to create a more efficient and effective system, while providing a high standard of investor protection across the country.

Alberta also continued to be a leader as the first province to review income trusts. Input from public consultations and a discussion paper helped in the development of legislation which passed through the spring session of the legislature.

The hard working and dedicated staff within the Ministry saw a few changes this year. Not only do they have a new Minister, but also the decision was made to bring Alberta Finance and Alberta Revenue together again.

We have so much to be thankful for as we celebrate our province's centennial. As we look back at the successes that have been achieved and challenges overcome to make Alberta what it is today, we are solidly on course to enter our second century.

*[Original Signed]*

Shirley McClellan
Minister of Finance
September 22, 2005

# MANAGEMENT'S RESPONSIBILITY FOR REPORTING

The executives of the individual entities within the Ministry have the primary responsibility and accountability for their respective entities. Collectively, the executives ensure the Ministry complies with all relevant legislation, regulations and policies.

Ministry business plans, annual reports, performance results and the supporting management information are integral to the government's fiscal and business plans, annual report, quarterly reports and other financial and performance reporting.

Responsibility for the integrity and objectivity of the consolidated financial statements and performance results for the Ministry rests with the Minister of Finance. Under the direction of the Minister, as Deputy Minister, I oversaw the preparation of the Ministry's Annual Report, including consolidated financial statements and performance results. The consolidated financial statements and the performance results, of necessity, include amounts that are based on estimates and judgments. The consolidated financial statements are prepared in accordance with the government's stated accounting policies.

In addition to program responsibilities, I establish and maintain the Ministry's financial administration and reporting functions. The Ministry maintains systems of financial management and internal control which give consideration to costs, benefits, and risks that are designed to:

- provide reasonable assurance that transactions are properly authorized, executed in accordance with prescribed legislation and regulations, and properly recorded so as to maintain accountability of public money,
- provide information to manage and report on performance,
- safeguard the assets and properties of the Province under Ministry administration,
- provide Executive Council, Treasury Board and the Minister of Finance any information needed to fulfill their responsibilities, and
- facilitate preparation of ministry business plans and annual reports required under the *Government Accountability Act*.

In fulfilling my responsibilities for the Ministry, I have relied, as necessary, on the executives of the individual entities within the Ministry.

*[Original Signed]*

Brian Manning
Deputy Minister of Finance
September 22, 2005

# OVERVIEW 2005

- MINISTRY VISION, MISSION AND CORE BUSINESSES
- RELATIONSHIP OF REPORTING ENTITIES TO CORE BUSINESSES
- OPERATIONAL OVERVIEW
- SUMMARY OF KEY ACTIVITIES IN THE PAST YEAR

# VISION, MISSION AND CORE BUSINESSES

## Vision

A province that is innovative and globally competitive with a fiscally sustainable and accountable government.

## Mission

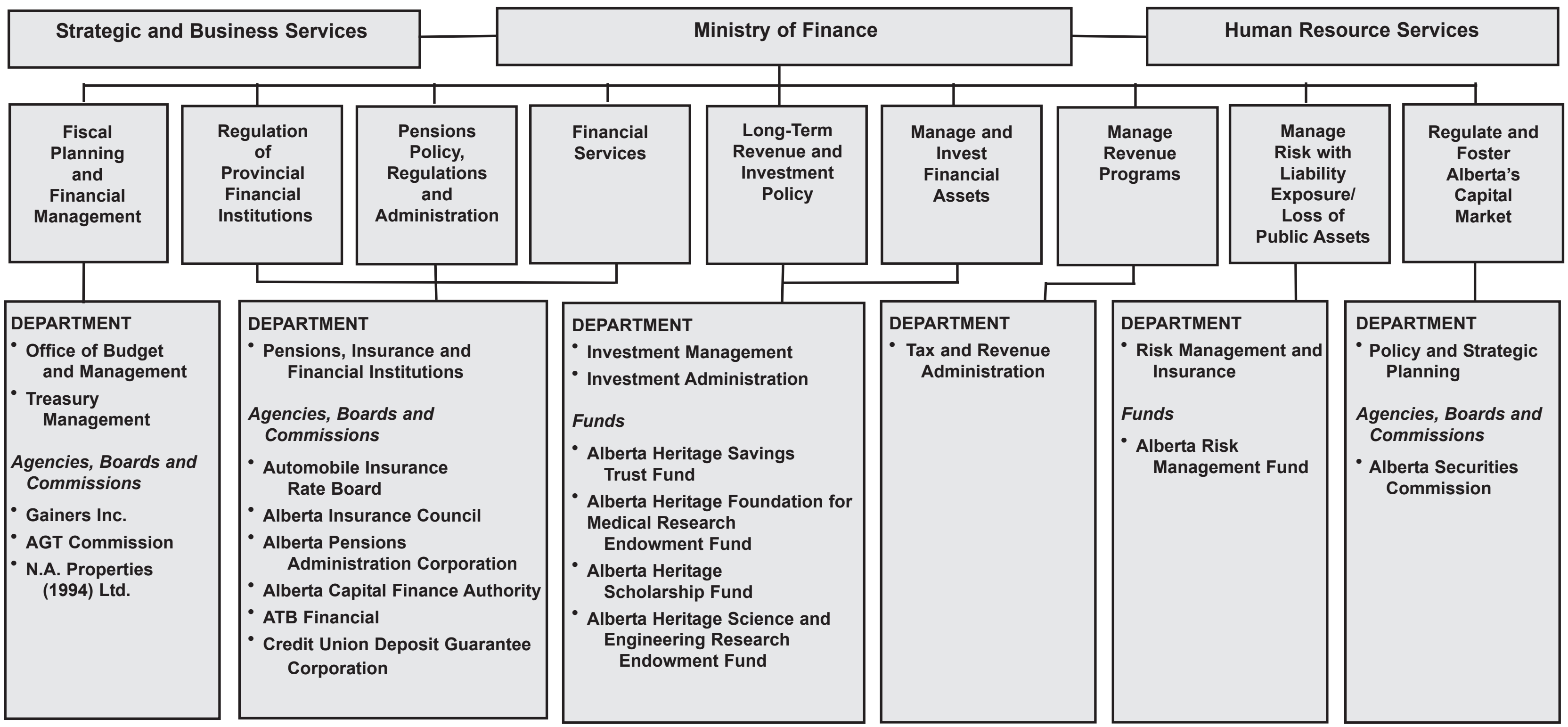
Implement the government's fiscal framework and financial policies and provide innovative revenue, investment and risk management.

## Core Businesses and Goals

| | |
|---|---|
| Core Business: | Fiscal Planning and Financial Management |
| Goal 1 | A Financially Strong, Sustainable and Accountable Government |
| Goal 2 | A Fair and Competitive Provincial Tax System |
| Goal 3 | Effective Management of Financial Assets, Liabilities and Risks |
| Core Business: | Regulation of Provincial Financial Institutions |
| Goal 4 | Reliable and Competitive Financial and Insurance Products and Services |
| Core Business: | Pensions Policy, Regulations and Administration |
| Goal 5 | Pensions that Deliver on Promises |
| Core Business: | Financial Services |
| Goal 6 | Quality and Competitive Financial Services Accessible to Albertans and Local Authorities |
| Core Business: | Long-Term Revenue and Investment Policy |
| Goal 7 | A Revenue Structure that Meets Alberta's Needs and is Consistent with Albertans' Values |
| Goal 8 | Investment Policies that will Provide the Greatest Financial Returns for Current and Future Generations of Albertans |
| Core Business: | Manage Revenue Programs |
| Goal 9 | Revenues Due to the Province are Collected Fairly, Efficiently and Effectively |
| Goal 10 | Excellence in Client Service |

| | | |
|---|---|---|
| Core Business: | | Manage and Invest Financial Assets |
| | Goal 11 | Superior Investment Returns Subject to Client-Defined Objectives and Policies |
| | Goal 12 | Excellence in Client Service |
| | Goal 13 | An Effective Investment Management Organization |
| Core Business: | | Manage Risk Associated with Liability Exposure and Loss of Public Assets |
| | Goal 14 | Proactively Managed Risk |
| Core Business: | | Regulate and Foster Alberta's Capital Market |
| | Goal 15 | An Effective, Efficient and Streamlined Securities Regulatory System |

# RELATIONSHIP OF FINANCE DEPARTMENT AND REPORTING ENTITIES TO CORE BUSINESSES



# OPERATIONAL OVERVIEW

**MINISTRY OF FINANCE** www.finance.gov.ab.ca

| | | |
|---|---|---|
| 9515 - 107 Street<br>Edmonton, Alberta<br>T5K 2C3 | 9811 - 109 Street<br>Edmonton, Alberta<br>T5K 2L5 | 1100, 715-5th Avenue S.W.<br>Calgary, Alberta<br>T2P 2X6 |

## Office of Budget and Management

The Office of Budget and Management (OBM) manages the provincial budget and business plan review and approval process, prepares economic and fiscal forecasts, and provides research, analysis and recommendations on the Province's fiscal, economic and taxation policies. OBM is responsible for intergovernmental fiscal relations and for providing statistical information about the Province. It also proposes and prepares accounting and financial control policies, budget documents, quarterly budget updates, annual financial statements and performance measurement reports.

OBM is divided into the following six areas: Budget Planning and Integration; Business Planning; Economics and Public Finance; Financial Accounting and Standards; Performance Measurement; and Tax Policy.

## Treasury Management

Treasury Management (TM) is responsible for the Province's on-going cash management including short-term borrowing and investments, management of banking and cash forecasting, and arranging short and long term financing for the government and provincial corporations. TMD is also responsible for managing the investment of the assets of the General Revenue Fund set aside for specific purposes such as debt retirement, sustainability and capital projects and monitoring and managing loans and guarantees. The division provides financial and banking advice to other government departments including active involvement in the Province's P3 projects.

TMD is divided into the following three areas: Capital Markets; Loans and Guarantees; Banking and Cash Forecasting.

## Pensions, Insurance and Financial Institutions

Pensions, Insurance and Financial Institutions (PIFI) is responsible for the regulation of credit unions, loan and trust corporations, financial institutions, insurance companies and private sector pension plans. It also provides policy support and analysis to the Minister of Finance in these areas, as well as for Alberta Treasury Branches, public sector pension plans and the Canada Pension Plan. The Division is also the government contact for the following six entities that report to the Minister of Finance: Automobile Insurance Rate Board; Alberta Insurance Council; Credit Union Deposit Guarantee Corporation; Alberta Pensions Administration; Alberta Treasury Branches and Alberta Capital Finance Authority.

PIFI is divided into the following five areas: Pensions; Insurance; Financial Institutions; Public Sector Pension Policy; and Divisional Support.

## Alberta Investment Management

Alberta Investment Management (AIM) is comprised of three operating groups: the Investment Management Division (IMD), the Investment Administration Division (IAD), and the Internal Audit and Compliance Office (IACO).

## Investment Management Division

Investment Management Division (IMD) is the fifth largest public sector asset manager in Canada with $47.2 billion in assets under management. IMD was established to act as the investment manager for pools of capital assigned by statute to the Minister of Finance and for the assets of other provincial public sector bodies, where specific agreements have been made.

IMD is organized into nine functional areas: Portfolio Analysis and Research, Active Canadian Equities, Fixed Income Operations, Structured Investments, Fund Management, External Fund Management, Real Estate, Mortgages and Private Placements.

IMD provides a comprehensive set of products including asset coverage such as fixed income, public and private equities, real estate, commercial mortgages and absolute return strategies. In some cases specialized private sector investment managers are used to manage specific investment mandates.

IMD manages the assets of a broad range of client funds including six public sector pension funds, a number of endowment funds and other special purpose funds. Assets under management include:

- Pension Investments (totaling $20.6 billion) comprising the Local Authorities Pension Plan, the Public Service Pension Plan, the Management Employees Pension Plan, the Universities Academic Pension Plan, the Special Forces Pension Plan, the Special Forces Indexing Plan, the Provincial Judges and Masters in Chambers Pension Fund, the Provincial Judges Supplementary Retirement Pension Plan, and the Supplementary Retirement Plan for Public Service Managers.
- Government Investments (totalling $23.8 billion) comprising the General Revenue Fund, including the Sustainability Fund, the Debt Retirement Account, the Capital Account, the Alberta Heritage Savings Trust Fund, the Alberta Heritage Foundation for Medical Research Endowment Fund, the Alberta Heritage Scholarship Fund, the Alberta Heritage Science and Engineering Research Endowment Fund, the Ultimate Heir Trust "B" Endowment Fund and other government portfolios.
- Other Investments (totaling $2.8 billion) comprising the Balancing Pool Corporation, funds managed on behalf of the Workers' Compensation Board, the Long Term Disability Fund Bargaining Unit, the Long Term Disability Fund Management, Opted Out and Excluded Employees, and other funds.

## Investment Administration Division

Investment Administration Division (IAD) has three internal groups: Securities Administration, Investment and Debt Information Systems, and Valuation and Fund Accounting.

IAD provides support for investment operations including:

- trade transaction monitoring and processing,
- fund and portfolio valuation and performance measurement,
- custodial bank interface and oversight,
- investment systems oversight, and
- systems support, development and maintenance.

Securities Administration works with the Investment Management Division (IMD) to ensure investment data is captured appropriately in the systems and that the financial transactions are settled with the corresponding brokers and financial institutions. Investment and Debt Information Systems is responsible for all of the software development, systems development and support required within IAD, IMD, and the Treasury Management Division. Valuation and Fund Accounting prepares the weekly valuation of investment portfolios, measures investment performance, and processes pooled fund unit transactions.

## Internal Audit and Compliance Office

Internal Audit and Compliance Office (IACO) is responsible for a risk-based compliance and internal audit program for the investment operation. This group is headed by the Lead Internal Audit and Compliance Officer and is independent of any investment unit.

IACO reviews the reliability and integrity of financial, administrative and operational information. This is accomplished by reviewing operations and programs to ascertain whether they are being carried out as planned, and whether the results of operations are consistent with the established goals and objectives.

## Tax and Revenue Administration

Tax and Revenue Administration (TRA) is responsible for the collection of revenue; the administration of Alberta Finance's tax, revenue and related benefit programs; and provides input into the design and development of these programs. The focus is a fair, competitive, simple and efficient provincial tax and revenue system.

TRA is divided into the following areas: Revenue Operations; Audit; Tax Services; and Business Technology Management.

## Risk Management and Insurance

Risk Management and Insurance Division (RMI) collaborates with ministries and agencies throughout government to assist them with identifying, measuring, controlling, and financing the risk of accidental loss. The program is responsible for all “participants” subject to the *Financial Administration Act*.

RMI is divided into two branches: Risk Management Operations and Claims Management. Risk Management Operations assists participants to identify, minimize and, where appropriate, finance adverse effects of accidental loss. Claims Management administers all claims covered under the province’s Risk Management Fund and makes recommendations aimed at reducing risk.

## Policy and Strategic Planning

Policy and Strategic Planning (PSP) is responsible for short and long-term revenue analysis, and for policy development to support the Ministry’s core businesses and goals. Policy and Strategic Planning works closely with Tax and Revenue Administration and the Office of Budget and Management.

PSP provides oversight of securities regulation in Alberta and support to the Endowment Fund Policy Committee, which provides advice on appropriate investment policies for Alberta’s endowment funds.

# REGULATORY AGENCIES

**Automobile Insurance Rate Board (AIRB)** www.airb.gov.ab.ca

#200, 9515 - 107 Street
Edmonton, Alberta
T5K 2C3

The AIRB is responsible for annually setting premiums for compulsory automobile coverage and monitoring optional coverages.

A copy of the AIRB's annual report can be obtained from its internet site or by contacting the Edmonton office.

**Alberta Insurance Council (AIC)** www.abcouncil.gov.ab.ca

#901, TD Tower, 10088 - 102 Avenue
Edmonton, Alberta
T5J 2Z1

The AIC is responsible for examining, licensing, and disciplining insurance agents, brokers and adjusters in Alberta and for investigating consumer complaints against the industry.

The Annual Report for AIC is available on its internet site.

**Credit Union Deposit Guarantee Corporation (CUDGC)** www.cudgc.ab.ca

18th Floor, 10130 - 103 Street
Edmonton, Alberta
T5J 3W9

CUDGC regulates business practices of Alberta credit unions and guarantees deposits according to legislation. While CUDGC strives to maintain the Deposit Guarantee Fund at a level that will enable the Corporation to independently provide the 100% deposit guarantee, the Government of Alberta will ensure that CUDGC can fulfill its guarantee obligation. The Corporation provides advice to Alberta credit union boards and management to help improve their skills and help them avoid unsound business practices or other problems.

The Annual Report for CUDGC is available on its internet site.

## Alberta Pensions Administration Corporation (APA) www.apaco.ab.ca

3rd Floor, 10611 - 98 Avenue
Edmonton, Alberta
T5J 2P7

APA provides pension services to boards, employers, members and pensioners of Alberta public sector pension plans. Those pension services consist of the collection of pension contributions, maintenance of member accounts, payments of pension benefits and provision of information.

Services are provided to 478 employers, approximately 174,000 active and deferred members, and 54,000 pensioners.

APA's Annual Report is available on its internet site.

## ATB Financial (ATB) www.atb.com

9888 Jasper Avenue
Edmonton, Alberta
T5J 1P1

ATB Financial (ATB) is a $15.4 billion, full-service financial institution based in Edmonton, Alberta. As a leading financial services provider to individuals, small business and the agri-industry in Alberta, it serves 600,000 Albertans in 242 communities through various branches and agencies, as well as through a Customer Contact Centre and the Internet.

Having the largest financial institution representation in the province, it is a preferred choice for many Albertans in smaller communities, and is an important alternative for a growing number of people in the major cities of Edmonton and Calgary.

ATB's Annual Report is available on its internet site.

**Alberta Capital Finance Authority (ACFA)** www.acfa.gov.ab.ca

2450 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, Alberta
T5J 3N6

ACFA is a non-profit authority established under the authority of the *Alberta Capital Finance Authority Act*. Its mission is to provide local authorities within the Province with flexible funding for capital projects at the lowest possible cost while still maintaining viability of the ACFA.

ACFA issues debt obligations that are guaranteed by the Province to deliver the lowest possible funding cost.

ACFA's Annual Report is available on its internet site.

**Alberta Securities Commission (ASC)** www.albertasecurities.com

4th Floor, 300 - 5th Avenue S.W.
Calgary, Alberta
T2P 3C4

The ASC is an industry-funded provincial corporation responsible for maintaining the efficiency and integrity of the capital market in Alberta through the administration of the *Securities Act*, the Securities Regulation and the Alberta Securities Commission Rules. As a member of the Canadian Securities Administrators (CSA), an organization consisting of the 13 provincial and territorial securities regulators, the ASC plays a vital role in developing and operating a national system of harmonized securities regulation, policy and practice.

The ASC is an administrative tribunal with quasi-judicial powers. Panels of members hear enforcement proceedings and consider applications for discretionary exemptions from the requirements of the securities legislation. The ASC also sits as an appeal body to hear appeals from decisions of the Executive Director, TSX Venture Exchange and the Alberta District Council of the Investment Dealers Association of Canada.

# SUMMARY OF KEY ACTIVITIES IN THE PAST YEAR

- In 2004-05, Alberta's accumulated debt was eliminated by allocating sufficient funds to the Debt Retirement Account to repay the debt as it matures.
- The budget was balanced for the eleventh consecutive year. As reported in the 2004-05 Government of Alberta Annual Report, the province ended the year with net revenue of $5 billion. This was $4.8 billion higher than budgeted.
- Despite continuing challenges with BSE, Alberta's economy remained strong in 2004. Employment grew by 40,000, or 2.3%, as Alberta recorded the lowest unemployment rate among the provinces, at 4.6%. High energy prices led to further strengthening of conventional energy sector activity following a dramatic upswing in 2003, and housing construction continued at high levels. Albertans also had the highest disposable income per capita in Canada, 15.9% higher than the national average. Overall, Alberta's economic growth for 2004 is estimated at 3.7%.
- In 2004-05, the Alberta Heritage Savings Trust Fund earned investment income of $1.1 billion. Investment income generated by the Heritage Fund is transferred to the General Revenue Fund where it is used for Albertans' priorities such as health care and education.
- Alberta maintained the highest credit rating among the provinces. Rating agencies cite Alberta's strong financial position, the government's commitment to debt repayment, and its record of balancing budgets and meeting forecasts as the key reason for the triple A credit rating.
- The *Fiscal Responsibility Act* was amended to increase the amount of non-renewable resource revenue that can be used for budget purposes to $4 billion from $3.5 billion. Changes to the *Fiscal Responsibility Act* also allow the cost of settlements with First Nations to be funded from the Sustainability Fund.
- Strong non-renewable resource revenue enabled the government to reach the Sustainability Fund's target of $2.5 billion. The fund provided almost $1 billion to pay for the cost of BSE assistance, wildfire costs, flood assistance and natural gas rebates.
- Alberta Finance coordinated the preparation, distribution and analysis of the *It's Your Future* survey, which received over 282,000 responses by mail and the internet. The survey sought guidance from Albertans as to their priorities for a debt-free province.

- Automobile insurance reform remained a priority in 2004-05. The government implemented reforms on October 1, 2004 ensuring the auto insurance system rewards safe drivers, makes bad drivers pay more and ensures fair compensation for all Albertans injured in motor vehicle accidents. Bill 34, the *Insurance Amendment Act*, 2005, was introduced on March 21, 2005, to provide further reforms and clarification on changes to automobile insurance. Public insurers from other provinces are also now able to compete in the Province's insurance market.
- Indexing of Alberta's single-rate personal income tax system continued to benefit Albertans through an income exemption of $14,523, the highest in Canada. A family of four can earn up to $36,100 in 2004-05 before paying provincial income taxes, with the Alberta Family Employment Tax Credit offsetting any taxes paid up to that level. Overall, Albertans pay the lowest taxes in Canada, with low taxes on income and fuel, and no retail sales tax.
- Effective April 1, 2004, the general corporate income tax rate was reduced to 11.5% from 12.5%, and the small business rate reduced to 3% from 4%. These reductions ensure Alberta's business taxes remain among the lowest in Canada, and resulted in an overall estimated savings of $142 million in taxes for Alberta businesses in 2004-05.
- Alberta Finance provided significant policy support for issues related to the goal of fair and competitive provincial tax and revenue systems. The Ministry worked with Innovation and Science, and Economic Development to bring forward a comprehensive *Ministers Report on Accelerating Innovation*. Low personal and corporate tax rates will remain one of the foundations of Alberta's economic policy.
- The collection of revenue was enhanced by increasing auditing of key areas. Increased capacity planned for the coming year is expected to result in greater collection of revenue and decreased tax evasion.
- The hotel room tax was converted into a tourism levy, effective April 1, 2005. The *Hotel Room Tax (Tourism Levy) Amendment Act*, *2005*, was introduced on March 14, 2005, changing the name to tourism levy and reducing the rate to 4% from 5%.
- Alberta provides tax exemptions and rebates on fuel used off-road for commercial purposes. The Tax-exempt Fuel Use program currently provides benefits of about $120 million per year, including about $45 million in the form of rebates. In response to industry concerns about the complexity surrounding the filing and rebate process, stakeholders were consulted, resulting in the development and implementation of a simplified system.

- On September 30, 2004, Alberta signed the *Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation*. The agreement commits participating jurisdictions to simplify and harmonize securities regulation and to create a "passport system" for securities regulation, resulting in a single window of access to capital markets. The *Securities Amendment Act*, *2005,* was introduced on March 14, 2005, to harmonize Alberta's securities regulations with other provinces and territories, provide greater protection for investors, and make it easier for businesses to access capital markets in more than one province or territory.
- The *Income Trusts Liability Act*, 2004, was proclaimed July 1, 2004, to improve investor protection. The Act limits liability for unit-holders of publicly traded income trusts. Other provinces are following Alberta's lead on this issue. The government also led a consultation process on the governance of income trusts, which included the release of a discussion paper in the summer of 2004 and public consultations in Edmonton and Calgary.
- The government continued to manage its financial assets and liabilities effectively. Returns on the Sustainability Fund and assets in the Debt Retirement Account exceeded performance benchmarks. Through seeking alternate markets and negotiating low commission costs, the government saved the Province and its corporations an estimated $1.3 million on borrowing of $766 million. Most of the borrowing in recent years has been on behalf of provincial corporations.
- Alberta Investment Management improved processes for strategic planning, including greater interaction with the Investment Operations Committee. The Committee governs investment operations and is chaired by the Deputy Minister of Finance and otherwise comprised of members independent of Alberta Government.
- New information technology systems were developed to allow Alberta Investment Management clients and product managers to identify and manage risks within their portfolios. A risk framework system was also developed to guide development of risk management processes in the future, and a new performance measurement and attribution system was introduced.
- Additional investment capacity through increased staffing and development of new products.
- Consultations were held on enhancing the Alberta Risk Management Fund to include risk financing for a broader range of losses. A list of enhancements was produced and the financial impact is being analyzed.
- Alberta Finance monitors provincially incorporated insurers, credit unions, trust and loan companies, and the Credit Union Central Alberta Ltd. All provincially regulated financial institutions and CUCA met solvency requirements, and no financial failures were recorded in 2004-05.

- The Minister of Finance is responsible for Alberta's public sector pension plans except the Teachers' Pension Plan, which falls under the Ministry of Education. The four major pension plans are: the Local Authorities Pension Plan, the Special Forces Pension Plan, the Public Service Pension Plan, and the Management Employees Pension Plan. Review of public sector pension plan governance is one of the department's strategic priorities. Work continued in 2004-05 to further strengthen governance of these plans. A Memorandum of Understanding was signed in September 2004 between the Alberta Pensions Administration and the Minister of Finance, to outline their roles and responsibilities, and clarify their working relationship.
- Alberta Finance administers the *Employment Pension Plans Act*. The Act safeguards the benefits promised to members of registered pension plans by setting minimum standards for funding, investment and qualifications for benefits. On March 23, 2005, Bill 35, the *Employment Pensions Plans Act* was introduced to give private sector pension plan members better access to information. The amendments also give the Superintendent more effective ways of monitoring the funding of pension plans by requiring more information about the plans' financial status and strengthening his enforcement powers. Of the pension plans registered in Alberta, 99% met the minimum funding requirements set out in the *Employment Pensions Plans Act*.
- ATB's net income for the year was $187 million. Total assets grew to $15.4 billion from $14.3 billion in the previous year. Retained earnings at March 31, 2005 were in excess of $1.1 billion.
- The Alberta Capital Finance Authority (ACFA) aims to offer the lowest cost of borrowing to the local authorities in Canada. ACFA compared Alberta local authorities' cost of borrowing to the costs of debt issues of the Municipal Finance Authority of British Columbia (MFABC) and the City of Toronto. The target was met for three of the four cases compared. The 20-year rate for MFABC was 3.4 basis points lower than the ACFA rate for that term.

# REPORT OF THE AUDITOR GENERAL ON THE RESULTS OF APPLYING SPECIFIED AUDITING PROCEDURES TO PERFORMANCE MEASURES

TO THE MEMBERS OF THE LEGISLATIVE ASSEMBLY

In connection with the Ministry of Finance's performance measures included in the *2004-2005 Annual Report of the Ministry of Finance* for the year ended March 31, 2005, I have:

1. Agreed information from an external organization to reports from the organization.
2. Agreed information from reports that originated from organizations included in the consolidated financial statements of the Ministry to source documents. In addition, I tested the procedures used to compile the underlying data into the source reports.
3. Checked that the presentation of results is consistent with the stated methodology.
4. Checked that the results presented are comparable to stated targets, and information presented in prior years.
5. Checked that the performance measures, as well as targets, agree to and include results for all of the measures presented in Budget 2004.

As a result of applying the above procedures, I found the following exception:

> For the measure *Number of accepted Financial Management Commission recommendations implemented as scheduled*, management asserts that 14 of the 22 accepted recommendations have been implemented. Management provided the final budget and business plan documents, but not the underlying data to support their assertion that they have implemented the first component of the following recommendation:
>
> *Recommendation No. 15- There should be regular reviews, including benefit-cost assessments, of all major government programs, policies and delivery mechanisms. The number of government departments and agencies should be reviewed.*

Therefore, I was not able to complete the relevant procedures for this measure.

Procedures 1 to 5, however, do not constitute an audit and therefore I express no opinion on the performance measures included in the *2004-2005 Annual Report of the Ministry of Finance*.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
August 18, 2005

# RESULTS ANALYSIS 2005

- MINISTRY FINANCIAL HIGHLIGHTS
- PERFORMANCE MEASURES, TARGETS AND RESULTS

# MINISTRY FINANCIAL HIGHLIGHTS

## REVENUE

(thousands of dollars)

| | 2004-05 | | 2003-04 |
|---|---|---|---|
| | Budget | Actual | Actual |
| **Revenues** | **$10,071,170** | **$10,852,483** | **$10,110,306** |

**Revenue for the Ministry was $742 million, or 7.3% higher.**
(Actual – Actual)

- $704 million of the increase is attributable to higher income tax revenues for 2005 with the large majority of the increase ($668 million) coming from higher corporate income taxes. The reason for the increase was higher corporate profits, which were offset by reduced corporate income tax rates. Personal income taxes contributed $36 million to the increase.
- Other taxes increased $62 million from 2004, which is made up of higher revenues collected from fuel, tobacco, insurance and hotel room taxes.

**Revenue for the Ministry was $781 million, or 7.8%, over budget.**
(Budget – Actual)

- Revenue from other taxes was over budget by $120 million due to higher-than-expected fuel and tobacco taxes collected caused by increased consumption in both areas. Insurance taxes were also higher due to higher economic activity.
- Investment income was higher than budget by $582 million due to increased realized investment gains as a result of stronger equity markets in the year.
- Internal government transfers were $71 million higher than budget due to increased transfers from the Alberta Heritage Savings Trust Fund and the Lottery Fund.
- Net income from commercial operations was $37.5 million higher than budget primarily due to higher earnings at Alberta Treasury Branches.
- Offsetting these increases was lower revenue from income taxes of $29.3 million. While corporate income taxes were $407 million higher than budget due to strong corporate earnings, personal income taxes were lower by $436 million mainly because of a negative adjustment in 2004-05 due to an over-estimate of personal income tax assessments for the 2003 taxation year.

## EXPENSE

(thousands of dollars)

| | 2004-05 | | 2003-04 |
|---|---|---|---|
| | Budget | Actual | Actual |
| **Expenses** | **$970,667** | **$907,608** | **$875,893** |

**Ministry expenses were $32 million, or 3.6%, higher.**
(Actual – Actual)

- The main reason for the increase was that debt servicing costs increased $31 million due to foreign exchange provisions on 2004 US dollar debt caused by the strengthening Canadian dollar.

**Expenses for the Ministry were $63 million, or 6.5%, under budget.**
(Budget – Actual)

- The Investment, Treasury and Risk Management Program was $14 million under budget primarily due to lower funding requests for research by the Alberta Heritage Foundation for Medical Research and the Alberta Heritage Foundation for Science and Engineering. In addition, reduced pension liability funding was required as a result of a lower pension payroll and cost of living adjustments.
- Debt servicing on the government debt was $61 million lower than expected due to accelerated debt elimination efforts during the year.
- The Financial Sector and Pensions Program was $11 million under budget mainly caused by lower than expected interest costs on the debt of Alberta Capital Finance Authority. Actual interest rates in 2005 were lower than budgeted.

# EXPENSE BY CORE BUSINESS

## MINISTRY EXPENSE BY 2004-05 CORE BUSINESS

(thousands of dollars)

| | 2004-05 Budget | 2004-05 Actual | 2003-04 Actual |
|---|---|---|---|
| Fiscal Planning and Financial Management | 443,161 | 377,401 | 347,744 |
| Regulation of Provincial Financial Institutions | 6,296 | 8,351 | 7,342 |
| Pensions Policy, Regulations and Administration | 26,302 | 25,228 | 25,375 |
| Financial Services | 313,687 | 304,789 | 320,037 |
| Long-term Revenue and Investment Policy | 1,982 | 1,041 | 796 |
| Manage Revenue Programs | 48,019 | 54,324 | 39,985 |
| Manage and Invest Financial Assets | 113,349 | 103,631 | 97,219 |
| Manage Risk Associated with Liability Exposure and Loss of Public Assets | 9,793 | 8,426 | 17,440 |
| Regulate and Foster Alberta's Capital Markets | 21,078 | 17,876 | 17,510 |
| | **983,667** | **901,067** [4] | **873,448** [4] |

## MINISTRY EXPENSE BY 2005-06 CORE BUSINESS

(thousands of dollars)

| | 2004-05 Budget | 2004-05 Actual | 2003-04 Actual |
|---|---|---|---|
| Fiscal Planning and Financial Management[1] | 60,130 | 64,706 | 49,650 |
| Investment, Treasury and Risk Management[2] | 555,511* | 480,629* | 450,418* |
| Financial Sector and Pensions[3] | 368,026 | 355,732 | 373,380 |
| | **983,667** | **901,067** [4] | **873,448** [4] |

# EXPENSE BY FUNCTION

(thousands of dollars)

| | 2004-05 Budget | 2004-05 Actual | 2003-04 Actual |
|---|---|---|---|
| Health | 55,279 | 50,185 | 50,157 |
| Education | 21,581 | 23,104 | 22,329 |
| Agriculture, Resource Management and Economic Development | 17,377 | 13,854 | 11,022 |
| Protection of Persons and Property | 23,702 | 20,441 | 19,911 |
| Regional Planning and Development | 313,595 | 304,692 | 319,943 |
| General Government | 197,113 | 194,293 | 186,979 |
| Debt Servicing Costs | 355,020 | 294,498 | 263,107 |
| | **983,667** | **901,067** [4] | **873,448** [4] |

1 Fiscal Planning and Financial Management includes the previous Fiscal Planning and Financial Management and the Manage Revenue Programs core businesses.
2 Investment, Treasury and Risk Management includes the previous Manage and Invest Financial Assets, Long-Term Revenue and Investment Policy, and the Manage Risk Associated with Liability Exposure and Loss of Public Assets core businesses.
3 Financial Sector and Pensions includes the previous Regulate and Foster Alberta's Capital Market; Regulation of Provincial Financial Institutions, and Pensions Policy, Regulations and Administration core businesses.
4 Excludes pension provisions of $6,541 for 2005 ($2,445 - 2004).
* Includes debt servicing costs. (Debt servicing costs not included in 2005-06 Finance business plan.)

# PERFORMANCE MEASURES, TARGETS AND RESULTS

## CORE BUSINESS: FISCAL PLANNING AND FINANCIAL MANAGEMENT

Alberta's strategy for protecting fiscal plans from revenue volatility associated with non-renewable resource revenue and investment income, and from costs of emergencies and disasters, while ensuring balanced budgets, has been to legislate a fiscal framework governing budgeting and financial management. Maintaining this framework – the *Fiscal Responsibility Act* (FRA) – is primarily the responsibility of Alberta Finance. In 2004-05, the framework was amended to increase the amount of non-renewable resource revenue that can be used for budget purposes from $3.5 billion to $4 billion, and to permit costs of settlements with First Nations to be funded from the Sustainability Fund.

In 2004-05, Alberta's accumulated debt was eliminated by allocating sufficient funds to the Debt Retirement Account to offset the province's remaining accumulated debt. The funds in the Debt Retirement Account will only be used to repay the accumulated debt as it matures.

Finance also coordinated the preparation, distribution and analysis of the *It's Your Future* survey, which received over 282,000 responses by mail and the internet. The survey sought guidance from Albertans as to their priorities with the new fiscal flexibility allowed by no longer having to allocate funds to debt repayment.

Finance has continued to provide assistance relating to the Capital Plan, advice on evaluation of Public Private Partnerships (P3s) and other alternative financing proposals, and on expanding the government's reporting entity.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: | | | |
| Fiscal Planning and Financial Management | $443,161 | $377,401 | $65,760 |

Debt servicing costs were $60.5 million lower than expected due to lower provincial debt balances. Pension liability funding was $2.7 million lower due to a lower pension payroll and cost of living adjustments. The remainder of the variance is attributed to higher staff vacancies, lower contract costs and lower write-offs of corporate income tax accounts.

## Goal 1 A Financially Strong, Sustainable and Accountable Government

A financially strong, sustainable and accountable provincial government is important, not only to Albertans, but also to potential investors, businesses and people looking to re-locate. This is another benefit of having a legislated fiscal framework, as it gives credibility to Alberta's fiscal commitment to balance budgets. In addition, Alberta continues to be conservative in economic and revenue forecasting. This encourages decisions to err on the side of prudence, which is essential in striving for sustainability in fiscal planning.

The financial results for 2004-05 reflect this prudent and risk-averse strategy. The budget was balanced for the eleventh consecutive year in 2004-05, with net revenue as reported under the *Fiscal Responsibility Act* of $5.2 billion, $4.9 billion higher than budgeted. In addition to making the final allocation of $3.7 billion to accumulated debt repayment, net revenue was employed to keep the Sustainability Fund above its $2.5 billion target level, and to increase assets in the Capital Account by $1.1 billion.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Alberta's credit rating | AAA | AAA | AAA |

Source: three rating agencies: Dominion Bond Rating Service, Moody's Investor Services and Standard and Poor's.

A province's credit rating, in part, is an indication of the financial strength of the government. The Province of Alberta provides financial and economic data to three rating agencies: Dominion Bond Rating Service, Moody's Investor Services Limited and Standard and Poor's Rating Services. These firms evaluate this and other relevant information and then publish a credit rating based on their opinion of the credit worthiness of the Province. The AAA rating is the highest rating to receive.

In all cases, Alberta received AAA ratings and is rated highest among all the provinces. The rating agencies cite Alberta's strong financial position, the government's commitment to debt repayment, and its record of balancing budgets and meeting forecasts as the key reason for the top rating. This has resulted in Alberta's borrowing costs being the lowest of any Canadian province.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Accumulated debt less cash set aside for debt repayment | $3.0 billion | Zero | $3.7 billion |

Source: Government of Alberta, Consolidated Financial Statements for the year ended March 31, 2005.

The level of accumulated debt is an indicator of the financial strength and long-term stability of the province. Debt burdens future generations with debt servicing costs and debt repayment obligations. Alberta's prudent fiscal management is reflected in the government's accelerated repayment of the Province's accumulated debt. As of March 31, 2005, Alberta's accumulated debt less funds locked in the Debt Retirement Account is zero. Accumulated debt includes the outstanding consolidated debt of the General Revenue Fund, the debt of the Alberta Social Housing Corporation (net of borrowings from the General Revenue Fund) and the government's liability for school construction.

The *Fiscal Responsibility Act* sets out the government's minimum required schedule to repay the $12.5 billion of accumulated debt that was remaining as of March 31, 2000 over a maximum of 25 years. The legislation includes five-year milestones for repayment of the accumulated debt.

Based on the debt repayment schedule set out in the *Fiscal Responsibility Act*, for the $12.5 billion of accumulated debt outstanding on March 31, 2000, the government is 20 years ahead of schedule in eliminating the need to set aside budget resources for debt repayment.

| Fiscal Year End | ($billions) |
|---|---|
| 1999-00 | 12.5 |
| 2000-01 | 8.2 |
| 2001-02 | 5.7 |
| 2002-03 | 4.7 |
| 2003-04 | 3.7 |
| 2004-05 | zero |

Source: Government of Alberta, Consolidated Financial Statements for the year ended March31, 2005

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Number of accepted FMC recommendations implemented as scheduled | 15 of 22 (accumulated) | 14 of 22 (accumulated) | 11 of 22 (accumulated) |

Source: Alberta Finance.

In July 2002, the Financial Management Commission (FMC) submitted a report containing 25 recommendations to the Minister of Finance. A formal government response was published in September 2002 accepting 22 of the 25 recommendations. As of March 31, 2005, Alberta Finance has overseen the implementation of 14 of the 22 (63%) FMC recommendations. This is one short of the target for 15 completed recommendations. Recommendation #4 on capital spending was not met due to the government's focus to determine and meet infrastructure priorities rather then setting a benchmark. This measure is not carried forward in the 2005-08 Finance Business Plan. The government is committed to completing the remaining recommendations by the end of fiscal 2006-07.

The FMC recommendations are available at www.finance.gov.ab.ca or the FMC website at www.albertafmc.com.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Percentage of Albertans who think they get enough information on the government's financial performance | 70% | 55% | 57% |

Source: Alberta Finance, Survey conducted for Alberta Public Affairs Bureau by Environics West in February 2005.

Alberta is dedicated to being financially open and accountable and has become a leader among Canadian governments in financial reporting. The provincial government reports quarterly to Albertans on progress made in achieving the current year's fiscal plan. The *Government Accountability Act* sets out the reporting requirements that provide government accountability.

Alberta is a leader among the Canadian governments in financial reporting, however, out of the 1,000 adult Albertans surveyed, 55% were satisfied with the information they received from the province on the government's financial performance in 2004-05. This is down from 57% in 2003-04 and below the target of 70%. The results are reliable to within +/- 3.0%, 19 times out of 20. This measure is under review to determine if the survey question properly reflects Albertans' satisfaction with the government's efforts to be open and accountable.

## Goal 2 A Fair and Competitive Provincial Tax System

Alberta's tax system is fair and competitive. It incorporates a low-rate, broad-based tax regime, rather than introducing special tax incentives that favour one group over another. In addition, our high basic and spousal amounts allow people to earn more money before paying any personal income tax. Alberta's low personal and corporate taxes translate into a competitive tax system that helps attract workers and investment, creating a strong provincial economy.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Provincial tax load for a family of four | Lowest in Canada | Lowest in Canada | Lowest in Canada |

Source: Alberta Finance, Office of Budget and Management, and Tax and Revenue Administration.

Alberta has the lowest provincial tax load for the representative two-income families who have annual incomes of $60,000 and $100,000 and the second lowest tax load for the representative single-income family earning $30,000.

Overall, Albertans pay the lowest taxes in Canada, with low taxes on income and fuel and no retail sales tax. The personal tax load on Alberta for 2004-05 was the lowest in Canada at 50.8% of the national average. This is 2.8 percentage points lower than the 53.6% recorded in 2003-04 and far ahead of Alberta's nearest competitor, British Columbia, which is at 93.0% of the national average. Alberta's competitive tax regime helps attract people to live and work here, further fuelling an already dynamic economy.

**PROVINCIAL TAX LOAD FOR A FAMILY OF FOUR***

| | One-income family with two children earning $30,000 | Two-income family with two children earning $60,000 | Two-income family with two children earning $100,000 |
|---|---|---|---|
| **Alberta** | **406** | **3,933** | **7,224** |
| British Columbia | 2,896 | 5,271 | 8,636 |
| Saskatchewan | 2,386 | 5,334 | 9,703 |
| Manitoba | 2,821 | 6,188 | 11,671 |
| Ontario | 2,039 | 4,923 | 9,507 |
| Quebec | (936) | 5,579 | 14,106 |
| New Brunswick | 3,201 | 6,018 | 11,092 |
| Nova Scotia | 3,319 | 6,165 | 11,425 |
| Prince Edward Island | 3,813 | 6,866 | 12,029 |
| Newfoundland and Labrador | 4,278 | 7,516 | 13,608 |

* Includes provincial income, sales, payroll, tobacco and fuel taxes and health care insurance premiums.
Source: Alberta Finance, Interprovincial Tax and Health Care Insurance Premium Comparison, 2005; p. 140 of *Budget 2005* document.

Calculations are based on the following assumptions:

- Business is assumed to bear between 25% and 60% of the provincial sales tax, depending upon the provincial tax regime.
- Health care insurance premiums are net of premium subsidies.
- In provinces that impose payroll taxes, 75% is assumed to be borne by employees and 25% by employers. The same 75/25 split is assumed for the net health care insurance premiums.
- Fuel tax is based on estimated consumption of 3,000 litres per year for one-income families and 4,500 litres for two-income families.
- Tobacco tax is based on estimated consumption of 100 packs per adult per year.
- Registered Retirement Savings Plan/Registered Pension Plan (RRSP/RPP) contributions of $1,000, $7,800 and $13,500 are included in the calculation of personal income tax for the $30,000, $60,000 and $100,000 families, respectively.
- For two-income families, income and RRSP/RPP contributions are split 60/40 between the two spouses.
- The children in each family are assumed to be 6 and 12 years old.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Provincial tax load on businesses | Lowest in Canada | Second lowest in Canada | Third lowest in Canada* |
| | | | Lowest in Canada** |

* As reported in 2003-04 Finance Annual Report.
** Historical data was revised by Federal Department of Finance resulting in Alberta being the lowest.
Source: Alberta Finance.

In 2004-05, Alberta's tax load on business was the second lowest in Canada following Prince Edward Island. Finance will be reviewing the methodology and target of this measure as the outcomes of this measure as it is currently derived may be ambiguous. For example, a province in which the economy is struggling could appear to have a low tax load because money-losing corporations do not pay income tax. Also, provinces with a greater percentage of small businesses could appear to have a low tax load because the small business rate is lower than the general corporate rate.

In 2004, Alberta's business tax rate was reduced from 12.5% to 11.5%, and the small business rate dropped from 4% to 3%. Alberta does not have capital taxes, payroll taxes or general sales taxes on business purchases. The government continues to affirm its commitment to lower the general corporate income tax rate to 8.0%. Low overall taxes encourage entrepreneurs to start new businesses in Alberta or expand existing operations.

**TAX LOAD ON BUSINESS***

| | 2004-05 | 2003-04 |
|---|---|---|
| Prince Edward Island | 72.0 | 93.0 |
| **Alberta** | **77.0** | **69.0** |
| Ontario | 93.7 | 90.2 |
| New Brunswick | 95.1 | 91.1 |
| British Columbia | 101.7 | 105.1 |
| Quebec | 110.3 | 118.1 |
| Nova Scotia | 112.9 | 98.9 |
| Newfoundland and Labrador | 118.3 | 110.7 |
| Manitoba | 130.5 | 125.7 |
| Saskatchewan | 218.3 | 285.0 |

Tax load relative to provincial average = 100

Note: Historical data revised by Federal Department of Finance.
* Includes business income, capital tax and insurance corporation tax revenues.
Source: Federal Department of Finance, February 2005 Third Estimate for 2004-05.

Provincial tax load, or tax effort, compares actual tax revenues generated within a province to the revenue the province would generate if it taxed at national-average tax rates. Business taxes examined include business income taxes, capital taxes and insurance corporation taxes.

Each year, the provinces report their tax revenues by these categories to the federal government as part of the reporting requirements for the Equalization Program. The steps to calculate provincial tax loads are:

1. National-average tax rates are calculated by dividing total national tax revenues by the national tax base. The tax base for corporate income taxes, for example, is corporate profits.
2. The revenue the Province would generate if it taxed at national rates is equal to the national average tax rate multiplied by the provincial tax base for each of the tax categories.
3. The provincial tax load is equal to the ratio of actual provincial revenues divided by the results of the previous calculation multiplied by 100.

## Goal 3 Effective Management of Financial Assets, Liabilities and Risk

The Government of Alberta's annual cash flow must be managed to optimize returns and to ensure cash is available to meet Alberta's obligations. The Minister of Finance is also responsible for managing several billion dollars in certain assets and the remaining liabilities. Through prudent management of assets and liabilities, the Ministry works at minimizing financing costs and maximizing investment returns.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Return on: Sustainability Fund | To be determined | Return on the Fund exceeded the approved benchmark | Return on the Fund exceeded the approved benchmark* |

* Return on fund for 9 months exceeded both the 91 day and 365 day Scotia Capital Treasury Bill Indices.
Source: Alberta Finance, Treasury Management.

The Ministry established the Statement of Investment Policy for the Sustainability Fund that sets a performance measure for earnings in the Fund based on the Scotia Capital Treasury Bill indices for 91 days and 365 days.

The index returns for both indices for the period from April 2004 to March 2005 were 2.20%. The total return of the Sustainability Fund was 2.26%, which was greater than both the 91 day and 365 day Scotia Capital Treasury Bill indices.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Return on: Debt Retirement Account compared to the cost of the debt on the day the investment is made | Greater | 10 basis points higher than market return on matching debt | 6 basis points higher than market return on matching debt |

Source: Alberta Finance, Treasury Management.

Funds have been set aside from annual surpluses to meet the obligations on future debt maturities. The objective is to have cash available as debt matures and to invest the money in securities that return a higher rate of return than the cost of Province of Alberta debt that would have been issued on the day the investment is purchased. If the investment return exceeds the market cost on the debt, then the Province is able to earn that differential. In 2004-05, the funds invested exceeded the market return on the debt by 10.4 basis points.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Return on: Consolidated Cash Investment Trust Fund compared to Scotia Capital 91 Day Treasury Bill Index | Greater by 10 basis points* | Greater by 9 basis points* | Greater by 15 basis points* |

* Basis point is 1/100 of a per cent.
Source: Alberta Finance, Treasury Management.

The Consolidated Cash Investment Trust Fund (CCITF) is a money market fund used to manage the cash balances of the Province and other depositors in the fund. A benchmark for the return on the fund has been established at the Scotia Capital 91day Treasury Bill index plus 10 basis points. The benchmark return for 2004-05 was 2.30%. The one-year return on the CCITF was 2.29%, which was 1 basis point lower than the benchmark. The reason for the slight underperformance was low corporate spreads in a historically low interest rate environment.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| All in cost of debt issued compared to an issue of comparable term in the Canadian public debt market | Lower | Cost lower - savings of $1.3 million | Cost lower - savings of $1.2 million |

Source: Alberta Finance, Treasury Management.

In 2004-05, the ministry arranged the borrowing of $766 million for provincial crown corporations through public bond issues and private placements. Through seeking alternative markets and negotiating lower commission costs the ministry was able to save the Province and its corporations an estimated $1.3 million compared to selling the same bonds in the Canadian public market.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Government decision on enterprise risk management program | Government approval of framework | Ongoing | Ongoing |

Source: Alberta Finance, Treasury Management.

An enterprise risk management framework is one of Alberta Finance's strategic priorities. A large and complex organization such as the Government of Alberta faces many potential risks. Identification and management of these risks has become a priority for the government as a whole. Finance was originally given the task of developing an enterprise risk management framework for government consideration. In 2003-04 the leadership for this initiative became the responsibility of a sub-committee of the Deputy Minister's Council. Due to recent restructuring, the enterprise risk management program is currently under review.

## CORE BUSINESS: REGULATION OF PROVINCIAL FINANCIAL INSTITUTIONS

Finance sets the legislative and regulatory framework and with its delegated regulatory organizations regulates the credit union, loan and trust, and insurance industries in Alberta. By balancing the interests of stakeholders including depositors, policyholders, investors and the companies themselves, the Department helps to promote an efficient, fair and competitive financial sector in Alberta.

The Department also monitors the Credit Union Central Alberta Ltd. (CUCA) and, through the Credit Union Deposit Guarantee Corporation (CUDGC), guarantees the repayment of all deposits held with credit unions. Alberta Finance's role with respect to deposit insurance is to ensure CUDGC is capable of fulfilling its guarantee of credit union deposits.

Automobile insurance is compulsory to help ensure that Albertans are protected from loss when they are involved in an automobile collision. Alberta Finance regulates the industry and monitors availability, affordability and fairness of insurance to Albertans.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: Regulation of Provincial Financial Institutions | $6,296 | $8,351 | ($2,055) |

Overspending in the regulation of provincial financial institutions was due to additional costs incurred with the implementation of auto insurance reforms.

### Goal 4 Reliable and Competitive Financial and Insurance Products and Services

Albertans need to know that the financial services and products they receive are secure. Finance minimizes the risks relating to their products by regulating credit unions, insurance, loan and trust industries in Alberta.

In 2004-05, there were 60 credit unions operating in Alberta through 187 branches with assets exceeding $9 billion, 55 loan and trust corporations registered to conduct business in Alberta and 301 insurance companies licensed to conduct business in Alberta.

All provincially incorporated credit unions, loan and trust companies, insurance companies and the CUCA met minimum capital solvency requirements. No financial failures were recorded in 2004-05.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Automobile Insurance review completed | Recommendations implemented | Recommendations implemented | Review completed<br>Implementation completed in October 2004 |

Source: Alberta Finance, Pensions, Insurance and Financial Institutions.

Reforming Alberta's automobile insurance system continued to be a major priority for the Department of Finance in 2004-05. With the passing of Bill 53 in December 2003, the Department's focus this year was to implement specific reforms that would help achieve government's stated objective of an automobile system of insurance that would reward safe drivers, ensure bad drivers pay more while ensuring fair compensation for all Albertans injured in motor vehicle accidents.

This objective was fully achieved. With the passing of the *Insurance Amendment Act*, *2003 (No. 2)*, the Minor Injury Regulation, the Automobile Accident Insurance Benefits Amendment Regulation and the Diagnostic and Treatment Protocols Regulation, several reforms were implemented on the target date of October 1, 2004 including:

- a premium grid that establishes a maximum premium for compulsory coverage, varied only by territory and level of protection chosen;
- a $4,000 cap on awards for pain and suffering related to minor injuries;
- diagnostic and treatment protocols to help ensure quick access to effective and efficient treatment;
- introduction of an "all comers" rule that means the insurance company of an applicant's choice must offer a contract of insurance to the applicant;
- introduction of two risk sharing pools enabling insurers to share risks that they do not want to keep on their book;
- the Automobile Insurance Rate Board with the mandate to review and adjust premiums for compulsory coverage annually as required, to monitor optional coverages and to administer a dispute resolution committee to deal with matters of disagreement about the amount of a premium.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results |
|---|---|---|
| Revision of *Insurance Act* respecting contracts* | Review of *Insurance Act* | Ongoing |

* New measure in 2004-07 Business Plan.
Source: Alberta Finance, Pensions, Insurance and Financial Institutions.

Finance's second objective with respect to insurance is to review and rewrite the statutory provisions of the *Insurance Act* respecting contracts. Work is underway and the review of the Act is scheduled to be completed by 2006-07. A work plan will soon be finalized outlining all work to be completed, scheduled completion dates and details of the consultation process with stakeholders.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results |
|---|---|---|
| ATB Financial supervisory framework implemented* | Implemented | Implemented |

* New measure in 2004-07 Business Plan.
Source: Alberta Finance, Pensions, Insurance and Financial Institutions.

The target for implementing a supervisory framework was met. In conjunction with ATB, a framework and reporting standard was developed that will enable Alberta Finance to assess ATB's level of compliance with the *Alberta Treasury Branches Act*, Regulation and Guidelines. ATB plans to provide its first report against this framework and reporting standard in the summer of 2005.

## CORE BUSINESS: PENSIONS POLICY, REGULATIONS AND ADMINISTRATION

Finance is responsible for administration of the *Employment Pension Plans Act*. The purpose of the Act is to safeguard benefits promised to members of registered pension plans by setting minimum standards for plan funding, investments, and qualifications for benefits. In addition, Finance is responsible for providing policy advice to government for several Alberta public sector pension plans and the Canada Pension Plan. The Alberta Pensions Administration Corporation (APA) provides administrative services.

| FINANCIAL INFORMATION (thousands of dollars) | 2004-05 Budget | 2004-05 Actual | Variance |
|---|---|---|---|
| Expenses for Core Business: Pension Policy, Regulations and Administration | $26,302 | $25,228 | $1,704 |

The Alberta Pensions Administration Corporation was $1.3 million under budget due to the deferral of an information management initiative and lower spending on consulting services.

### Goal 5 Pensions that Deliver on Promises

Pension Plan members need to be assured that their benefits are secure. Finance assesses private sector pension plan compliance with legislative standards.

Finance currently monitors 1,311 private pension plans. Of these, 1,172 are active, 50 are in the process of being registered, and 89 are in the process of winding up. These plans have 180,536 active members. Total contributions were approximately $1.1 billion for the year ended March 31, 2005. The market values of total assets and going concern liabilities were $16.8 billion and $12.8 billion respectively, at the same reporting date.

Finance provides advice to the Minister on the funding and governance of the public sector pension plans. These plans include: the Local Authorities Pension Plan; the Special Forces Pension Plan; the Public Service Pension Plan; and the Management Employees Pension Plan.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Percentage of APA client members and employers satisfied or very satisfied with products and services | 95% of clients and employers | 88% | 79% |

Source: Alberta Pensions Administration (APA) Corporation.

Alberta Pensions Administration Corporation collects pension contributions, maintains member accounts, pays pension benefits and provides information to pension boards, employers, members and pensioners for seven public sector pension plans and two supplementary retirement plans. The Corporation also provides on-line support to its four main client pension plans.

In 2005, the Corporation surveyed more than 800 members, 2,400 pensioners and 160 employers to determine customer satisfaction with APA products and services. While the current overall satisfaction level of 88% is a significant improvement over last year's 79%, it is still less than the target overall satisfaction level of 95% (see below). The year over year increase is primarily attributable to an increase in employer satisfaction. Further information on the survey and other survey data is available at APA's website www.apaco.ab.ca.

**SURVEY RESULTS**

| | Satisfaction | Response Rate |
|---|---|---|
| Members | 85% | 10% |
| Pensioners | 95% | 38% |
| Employers | 83% | 23% |
| **Total Average** | **88%** | |

Source: APA Corporation.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Improved pension governance frameworks | Developed and implemented | Partially met | In progress |

Source: Alberta Finance, Pensions, Insurance and Financial Institutions.

Review of public sector pension plan governance is identified as one of the department's strategic priorities. The objective is to clarify roles, responsibilities and accountabilities of Alberta Finance, the Pension Boards, Alberta Pensions Administration and Alberta Investment Management in relation to operational aspects of public sector pension plan governance.

The target to develop and implement a pension governance framework in 2004-05 was partially met. Work continued and several initiatives took place toward developing the governance framework. A Memorandum of Understanding (MOU) was signed in September 2004 that outlined the roles and responsibilities of both parties. In addition, consultation took place with pension boards and other stakeholders on how to strengthen governance over public sector pension plans.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Percentage of private sector plans that meet minimum funding requirements | 98% | 99% | 99% |

Source: Alberta Finance, Pension Benefits Information System.

Private sector pension plan sponsors must demonstrate they have adequate funding to pay promised benefits by filing annual information returns and having triennial actuarial valuations completed for defined benefit plans. Over the last few years, investment returns including those for registered private sector pension plans, have experienced significant declines that have reduced the market value of assets and increased the funding requirements of plan sponsors.

The *Employment Pension Plans Act* requires pension plan sponsors to meet minimum funding requirements by making current service contributions, to eliminate any unfunded liabilities by making special payments over a fifteen-year period and to eliminate any solvency deficits by making special payments over a five-year period. The Department's performance benchmark is that at least 98% of pension plans registered in Alberta meet these minimum-funding requirements.

This result was achieved as 99% of pension plans registered in Alberta met the minimum funding requirements outlined above.

## CORE BUSINESS: FINANCIAL SERVICES

Alberta Finance's goal is to ensure reliable and competitive financial products and services are accessible to Albertans and local authorities. ATB and the Alberta Capital Finance Authority (ACFA) are key components of the financial services sector in Alberta.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: Financial Services | $313,687 | $304,789 | $8,898 |

ACFA expenses were under budget by $9 million, which is attributable to lower interest costs on long-term debt resulting from lower interest rates.

### Goal 6 Quality and Competitive Financial Services Accessible to Albertans and Local Authorities

The mandate for ATB is to provide financial services predominantly to Alberta residents and corporations headquartered in all areas of the province. In doing so, ATB must operate using sound financial institution and business principles with the objective of earning a fair return and in a manner that is operationally independent from government. In addition to the *Alberta Treasury Branches Act* and regulations, ATB must comply with statutory provisions that apply to Alberta Crown agents in general, with government policies specified by the Minister, and with management principles adopted by government.

ATB is a full service financial institution serving more than 600,000 Albertans through 148 branches and 131 agencies in Alberta. Approximately one half of its assets are in residential mortgages and consumer loans, with the balance about equally divided between commercial, agricultural and independent business loans. ATB is the largest lender to primary producers and independent business in Alberta with about $3 billion in loans outstanding to these sectors at March 31, 2005.

ATB had a successful year with net income for the year ended March 31, 2005 of $187 million (compared to $172 million the previous year) and total assets growing to $15.4 billion at March 31, 2005 (up 8% from $14.3 billion in the previous year). Retained earnings at March 31, 2005 were in excess of $1.1 billion.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| ATB | | | |
| Loan loss provisions as a percentage of average total loans | 0.30% | -.12% | .13% |
| Expenses to operating revenue | 66.15% | 67.90% | 63.42% |
| Return on average assets (before tax) | 0.97% | 1.27% | 1.24% |

Source: ATB Financial (for further information, refer to ATB Financial Annual Report dated March 31, 2005).

ATB exceeded two of the three performance measures although the "expenses to operating revenue" target was not achieved due to modest overspending on non-interest expenses and less than planned net interest income. Overall, the financial results for ATB compare favourably to that of the major Canadian banks.

ACFA's mission is to provide local authorities within the province with flexible funding for capital projects at the lowest possible cost while maintaining the viability of the ACFA.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Local authorities' costs of borrowing from ACFA relative to borrowing costs of other Canadian municipalities within the viability of the Corporation | Lowest | Met for 3 of 4 cases compared * | ** |

* MFABC 20-year rate was 3.4 basis points below ACFA 20-year rate(2004).
** Previous results are not comparable to the current results due to a change in methodology.
Source: ACFA Annual Report 2004.

ACFA aims to offer the lowest cost of borrowing to local authorities in Canada. ACFA compares Alberta local authorities' indicative loan rates to the cost of borrowing of actual debt issues of the Municipal Finance Authority of British Columbia (MFABC) and the City of Toronto. The target was met for three of the four cases compared. The 20-year rate for MFABC was 3.4 basis points lower than the ACFA rate for that term.

The results reported for 2004 are based on a new methodology. The new methodology is believed to be a more accurate reflection of relative borrowing costs as it uses actual transactional data, rather than estimates to calculate the cost of funds for MFABC and the City of Toronto.

Using the new methodology, ACFA compares Alberta local authorities' indicative loan rates to the cost of borrowing on actual debt issues of MFABC and Toronto. It is assumed that MFABC will use these debt issues to fund new loans directly and will base their loan rated on actual borrowing costs. ACFA's indicative loan rates are estimates of what the Authority would achieve under similar terms and circumstances to the actual debt issues of other municipal issuers. MFADC and Toronto were selected for comparison because they reflect the size and credit rating of ACFA.

## CORE BUSINESS: LONG-TERM REVENUE AND INVESTMENT POLICY

Investment policies need to be tailored to specific goals. A long-term investment strategy is a balanced plan based on two important concepts: diversification to manage risk, and a long-term planning horizon to earn greater returns.

| FINANCIAL INFORMATION (thousands of dollars) | 2004-05 Budget | 2004-05 Actual | Variance |
|---|---|---|---|
| Expenses for Core Business: Long-Term Revenue and Investment Policy | $1,982 | $1,041 | $941 |

Lower than expected spending on contract services contributed to the Revenue and Investment Policy business to come in under budget.

### Goal 7 A Revenue Structure that Meets Alberta's Needs and is Consistent with Albertans' Values

Through the revenue management framework, revenue and investment policies are designed to maximize productivity and wealth generation while preserving and enhancing the quality of life for Albertans.

Alberta's approach to taxes is part of the solid foundation for a dynamic and vibrant provincial economy, and means more opportunities, greater rewards for work and investment, and more wealth to support public service and quality of life.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Provincial tax load for a family of four | | See measure in Goal 2 | |
| Provincial tax load on businesses | | See measure in Goal 2 | |

## Goal 8 Investment Policies that Will Provide the Greatest Financial Returns for Current and Future Generations of Albertans

The mission of the Alberta Heritage Savings Trust Fund (the Heritage Fund) is to provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans.[1]

The Heritage Fund was created in 1976 to save a portion of non-renewable resource revenue. In 1997, the Alberta government adopted a new investment strategy for the Heritage Fund. This new strategy focuses on earning the greatest long-term returns for Albertans, within an acceptable level of risk. During the fiscal year, the Heritage Fund (along with Alberta's other endowment funds) continued implementation of the new asset mix that was designed to meet this objective. This new asset mix was included in the Heritage Fund's new Statement of Investment Policy and Goals that provides for prudent investment management and increased governance and oversight.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results |
|---|---|---|
| Five-year market value rate of return of the Heritage Fund investment policy benchmark compared against Consumer Price Index (CPI)* | Equal to or better than CPI plus 4.5% (new target for the Heritage Fund) (target return was 6.61%)* | 6.43%**, which is 0.18% below the target |

* As this is a new performance measure, one-year market value rate of return of the Heritage Fund investment policy benchmark is compared to one-year CPI plus 4.5% in the fiscal year 2004-05. In the future, the performance measure and target will be changed based on how many years the new measure is in use until it builds up over time to five years. After five years the performance measure and target stays fixed and will be calculated as an annualized five-year market value rate of return of the Heritage Fund investment policy benchmark compared against annualized five-year CPI plus 4.5%.
** One-year market value rate of return of the Heritage Fund is 7.75% as of March 31, 2005. Refer to the *2004-05 Alberta Heritage Saving Trust Fund Annual Report* for further details.
Source: Alberta Investment Management, Finance.

Assets and income of the Heritage Fund are fully consolidated with the assets and revenue of the Province. Income earned during a fiscal year is transferred to the General Revenue Fund, except for any portion retained for inflation proofing.

1 Preamble to the *Alberta Heritage Savings Trust Fund Act*.

## CORE BUSINESS: MANAGE REVENUE PROGRAMS

Alberta continues to stand out from the provincial crowd as a leader in low taxes for residents and businesses. Alberta's low rate, broad-based approach to taxes is fairer and simpler for all taxpayers. It contributes to a dynamic and vibrant provincial economy, and means more opportunities, greater rewards for work and investment, and more wealth to support public services and quality of life. Alberta Finance reviews policies and processes to ensure a fair and competitive tax environment in Alberta and maintain Alberta's tax advantage.

Albertans enjoy the advantages of an innovative and low personal tax system, low property and fuel taxes, and no general sales taxes. Low corporate income tax rates, no general sales tax on business inputs, no general payroll taxes and no capital taxes put Alberta businesses in an enviable position.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: Manage Revenue Programs | $48,019 | $54,324 | ($6,305) |

Interest payments on corporate tax refunds were higher by approximately $7.3 million resulting from a few large objection settlements reached by Canada Revenue Agency that triggered similar reassessments in Alberta. This was partially offset by lower than anticipated manpower costs of approximately $1.3 million due to more position vacancies than budgeted.

### Goal 9 Revenues Due to the Province are Collected Fairly, Efficiently and Effectively

Collecting taxes fairly, efficiently and effectively means that all taxpayers and claimants are treated with respect, receive excellent value for money spent on tax programs, and tax-evasion-related revenue losses are minimized.

| **PERFORMANCE MEASURE** | **2004-05 Target** | **Current Results** | **Previous Results** |
|---|---|---|---|
| Percentage of tax accounts with no monies owing | 96% | 96% | 96% |

Source: Alberta Finance, Tax and Revenue Administration.

As at March 31, 2005, the actual percentage of accounts with no overdue amounts owing was 96%. This result of consistently high performance demonstrates that Alberta's tax enforcement efforts are successful.

"Tax accounts with no monies owing" is defined as the number of tax accounts reporting no receivables as of March 31, 2005. The total number of tax accounts is overstated due to corporations not reporting their inactive status. This measurement uncertainty would result in a higher percentage of the accounts with no monies owing.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Ratio of amounts added to net revenue to costs of administration | 12:1 | 9.6:1 | 14:1 |

Source: Alberta Finance, Tax and Revenue Administration.

Through the revision of returns and claims, Finance collects overdue accounts to recover revenues that otherwise may be lost. The calculation is based on the total additional revenue obtained, shown as a ratio of the total costs of Tax and Revenue Administration's expense budget.

The total amount added to net revenue for 2004-05 was $216.6 million, and the associated costs were $22.6 million, resulting in a value added ratio of 9.6 to 1; that is, recoveries of $9.60 for every $1 spent. A number of factors have contributed to the lower ratio, including audits being underway where assessments had not yet been completed, and a higher than normal staff vacancy level combined with existing resources having to be channelled into training new staff.

Plans are in place to expand audit coverage, which should result in progress toward better self-compliance.

## Goal 10 Excellence in Client Service

Finance conducts an annual survey to determine client satisfaction of services provided by TRA for its tax and rebate programs, and the clients' cost to comply with the relevant legislation. In 2004-05 the survey instrument was redesigned to address both TRA and client needs. Surveys were sent to clients in each tax or rebate program with a population of 100 or less. A random selection tool was used to send surveys to a portion of clients in each tax or rebate program with a client population of 100. The sample size was set to obtain results that are at a 95% confidence level, 19 times out of 20.

Client comments are considered and, where appropriate and feasible, changes are implemented. For example, TRA responded to concerns expressed by industry about the complexity of reporting for Tax-exempt Fuel Use (TEFU) with the Prescribed Rebate Off-road Percentages (PROP) program. A Special Notice clarifying requirements was issued when questions arose around the Alberta Indian Tax Exempt sale of fuel and tobacco to Indian bands.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Client satisfaction with tax administration | 85% | 87% | 89% |

Source: Alberta Finance, www.finance.gov.ab.ca/publications/tax_rebates/rates_surveys_tnotes/ clientsurvey04.html.

In 2004-05, overall client satisfaction with tax administration was 87% and exceeded the minimum 85% performance target. This was down slightly from 89% when compared with 2003-04 results. Results exceed the target in the areas of courtesy (91% satisfaction expressed), effort (going the extra mile) with slightly below 90%, knowledge (90%), and accessibility (89%). Timeliness measured at just below the target at 84% satisfaction.

## CORE BUSINESS: MANAGE AND INVEST FINANCIAL ASSETS

An important objective of Alberta Investment Management (AIM), Alberta Finance is to create portfolios that match the risk profiles and financial goals of clients' funds. Emphasis is placed on diversification and long-term investment horizon while considering the current financial needs of clients' funds. To meet these objectives, AIM has developed a wide range of investment products that can be combined to meet specific financial goals and risk tolerances. This multi-product approach is implemented on a pooled basis. Clients buy into the pools by purchasing units based on the current market value of the pools' investments. This approach is important to managing the funds efficiently and to ensuring that each client is treated fairly.

Considering the volatility of the financial markets, it is expected that the majority of the funds' returns will come from the long-term asset allocation decision. Incremental return is added through tactical asset allocation and security selection decisions. These decisions reflect the shorter-term market expectations with consideration of both the risk and return. Both AIM and third party external manager expertise are used, ensuring the necessary specialized investment knowledge and skills are utilized in the most cost effective manner. External managers are used primarily for investing in foreign equity markets, certain domestic equity markets and absolute return strategies. Managers are chosen through a rigorous selection process and their performance is reviewed on a quarterly basis.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: Manage and Invest Financial Assets | $113,349 | $103,631 | $9,718 |

The Investment Management Division (IMD) experienced lower staffing levels and reduced contract service costs to come in under budget by $2.6 million. Transfers from the Alberta Heritage Foundation for Medical Research Endowment Fund and the Alberta Heritage Science and Engineering Research Endowment Fund were $8.8 million lower than anticipated. This was partially offset by higher transfers from the Alberta Heritage Scholarship Fund of $1.5 million.

### Goal 11 Superior Investment Returns Subject to Client-defined Objectives and Policies

The primary objective of AIM is to maximize long-term financial returns while controlling risk at prudent levels. Meeting this objective underscores the important balance between risk and return. The strategies outlined in the Ministry's Business Plan support this objective by applying a prudent mix of internal investment resources and external investment management firms, and by developing and implementing new products and strategies to meet client needs.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results |
|---|---|---|
| Five-year weighted average market value rate of return for endowment funds compared against the weighted average policy asset mix rate of return (benchmark) for endowment funds.* | Benchmark plus 0.5% (new target for all endowment funds) | All funds exceeded target* benchmark |

| ENDOWMENT FUND | 2004-05 Target* | Current Results* |
|---|---|---|
| Alberta Heritage Savings Trust Fund | 6.93% | 7.75% |
| Alberta Heritage Foundation for Medical Research Endowment Fund | 6.67% | 7.49% |
| Alberta Heritage Scholarship Fund | 7.27% | 8.09% |
| Alberta Heritage Science and Engineering Research Endowment Fund | 6.00% | 6.71% |
| Ultimate Heir Trust “B” Endowment | 7.05% | 7.52% |

* As this is a new performance measure, one-year market value rate of return of each endowment fund is compared against the one-year policy asset mix rate of return for that endowment fund in the fiscal year 2004-05. In the future, the performance measure and target will be changed based on how many years the new measure is in use until it builds up over time to five years. After five years the performance measure stays fixed and will be calculated as an annualized five-year weighted average market value rate of return for each endowment fund compared against the annualized five-year weighted average policy asset mix rate of return plus 0.5% for that fund.
Source: Alberta Finance, Alberta Investment Management.

## Goal 12 Excellence in Client Service

In January of each year Alberta Finance tabulates the results of a client satisfaction survey sent out to various clients of AIM. Respondents include board members representing client funds as well as other service recipients of AIM.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Client satisfaction with services provided | 80% | 67% | 69% |

Source: Alberta Finance, Alberta Investment Management.

Clients are asked to answer, on a five-point scale, a series of questions to determine their level of satisfaction with service received by AIM. Alberta Finance Office of Budget and Management translated the scale into a percentage satisfaction and aggregated with other clients into a composite client satisfaction level. The satisfaction level for the client question on overall quality of service from AIM, was used to produce the results for client satisfaction. Out of 20 clients surveyed, 18 responded resulting in a 90% response rate.

In the fiscal year 2004-05, client satisfaction with services provided reached 67%, which is a 2% decline over the fiscal year 2003-04, and below the 80% target. The decreased rating results mainly from decreased satisfaction with the overall quality of AIM's investment strategies, the value added performance of individual products, the value added by AIM relative to the fund benchmark and the overall quality of AIM's communications. An increase in client ratings was recorded in the following areas: AIM's understanding of client's investment objectives, the clarity of AIM's information on client's performance, client's overall understanding of AIM, AIM's understanding of client, risk tolerance and the investment products AIM provides to clients.

## Goal 13 An Effective Investment Management Organization

AIM completed several investment information technology initiatives during the 2004-05 fiscal year. The implementation of a new computer system was completed in April 2004. The new computer system will facilitate the consolidation of internally and externally managed holdings for timely client and portfolio management reporting. In addition, the implementation of a new performance measurement system and a risk measurement system were completed. The performance measurement system replaces a legacy system and allows for multi-currency performance and attribution at the portfolio level from a consolidated database. The risk measurement system provides system support for investment risk management and risk monitoring. These systems position the organization on par with comparable investment management organizations.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Straight Through Processing (STP) of investment transactions as measured by per cent of investment transactions with external parties transmitted electronically to custodian on trade date | 80% | 81% | 87% |

Source: Alberta Finance, Alberta Investment Management.

The majority of investment transactions with external parties are transmitted electronically. The goal is to ensure the trade transmission occurs on trade date. In 2004-05 the internal STP rate of 81% exceeded its target rate of 80%. This was down from 87% in 2003-04 because of a higher volume of trading activity in 2004-05 of instruments where trade transmission has not yet been fully automated.

## CORE BUSINESS: MANAGE RISK ASSOCIATED WITH LIABILITY EXPOSURE AND LOSS OF PUBLIC ASSETS

Finance supports the Government of Alberta by providing advice and education about risk, by minimizing loss and managing claims and by administering the Risk Management Fund. Through the Fund, risk financing is provided to ministries and, where appropriate, insurance is purchased to offset some of the Fund's potential costs.

| FINANCIAL INFORMATION (thousands of dollars) | 2004-05 Budget | 2004-05 Actual | Variance |
|---|---|---|---|
| Expenses for Core Business: Manage Risk Associated with Liability Exposure and Loss of Public Assets | $9,793 | $8,426 | $1,367 |

Insurance premiums paid to reinsurers and claim expenses were both lower than expected in the Alberta Risk Management Fund resulting in $1.4 million of reduced expense.

### Goal 14 Proactively Managed Risk

Finance administers a program to protect, secure and preserve public assets against risk of significant accidental loss. Through the development of a strong risk management team, Finance reviewed external and internal challenges and identified the need to proactively manage risk. Finance developed and implemented a strategy to improve the awareness of risk management within government. Core activities such as loss control, risk identification, claims management and risk financing were also assessed. In addition, a review was made on the need to enhance fund coverage. The sustainability of the funding was improved through modifications to the cost allocation system and is now responsive to the loss control efforts of participants.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results | Previous Results |
|---|---|---|---|
| Cost of claims (insurance premiums plus self-insured losses) | $8,150 | $6,610 | $15,800 |

Source: Alberta Finance, Risk Management financial statements.

The hard insurance market over the past few years has resulted in a significant erosion of commercial insurance coverage and a widening of exposure to the Alberta Risk Management Fund. In addition, the cost of the limited available commercial insurance has escalated considerably during the same period.

Notwithstanding the above, this year claims and the cost of premiums were less than budgeted. As such the actual cost of claims will be $6.61 million compared to a budgeted $8.15 million. This measure will be reviewed in the 2006-09 business planning cycle.

## CORE BUSINESS: REGULATE AND FOSTER ALBERTA'S CAPITAL MARKET

The Ministry identified the securities regulation as a strategic priority for 2004-05 and recognizes an effective securities regulation is vitally important to investor protection and efficient, vibrant and competitive local and national capital markets.

The Alberta Securities Commission (ASC) is responsible for maintaining the efficiency and integrity of the capital market in Alberta through the administration of the *Securities Act*.

| **FINANCIAL INFORMATION** (thousands of dollars) | **2004-05 Budget** | **2004-05 Actual** | **Variance** |
|---|---|---|---|
| Expenses for Core Business: Regulate and Foster Alberta's Capital Markets | $21,078 | $17,876 | $3,202 |

The ASC came in $3.2 million under budget due to a higher staff vacancy rate than forecast, continued strong cost control and deferral of certain policy projects and investor education costs.

### Goal 15 An Effective, Efficient and Streamlined Securities Regulatory System

An effective, efficient and streamlined securities regulatory framework is key to a strong and vibrant economy. It assists in the development of strong national and local capital markets and promotes the interests of both issuers seeking capital and investors providing that capital through their investment dollars.

| **PERFORMANCE MEASURE** | **2004-05 Target** | **Current Results** | **Previous Results** |
|---|---|---|---|
| Harmonized securities legislation | Proposal developed | Provincial/Territorial Memorandum of Understanding (MOU) signed | Canadian Securities Administration* |

* Legislation proposal for uniform securities legislation released December 2003.
Source: Alberta Finance, Policy and Strategic Planning.

In 2004-05, legislation was introduced to make Alberta's securities legislation more harmonized with the other Canadian jurisdictions. On September 30, 2004, a provincial/territorial Memorandum of Understanding (MOU) was signed by Alberta. The MOU includes a commitment to develop highly harmonized securities laws. The Alberta Government will continue to work with other provinces and territories on the commitment to develop, more broadly, highly harmonized securities legislation. For more information, visit the website at www.securitiescanada.org.

| PERFORMANCE MEASURE | 2004-05 Target | Current Results |
|---|---|---|
| Interprovincial system of securities regulation* | Established | Provincial/Territorial Memorandum of Understanding (MOU) signed |

* New measure in 2004-07 business plan.
Source: Alberta Finance, Policy and Strategic Planning.

This is a new measure as a result of the amendments introduced to the *Securities Act* to facilitate the implementation of the passport system. The system is designed to make it easier and less costly for firms wishing to access capital markets in more than one province or territory. The MOU signed on September 30, 2004 also included the development and implementation of a passport system. For more information, visit the website at www.securitiescanada.org.

# FINANCIAL INFORMATION 2005

- **FINANCIAL STATEMENTS OF THE MINISTRY AND ITS ENTITIES**
- **SUPPLEMENTARY INFORMATION REQUIRED BY LEGISLATION OR BY DIRECTION OF THE MINISTER OF FINANCE**

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**FINANCIAL STATEMENTS OF THE MINISTRY AND ITS ENTITIES**



**SUPPLEMENTARY INFORMATION REQUIRED BY LEGISLATION OR BY DIRECTION OF THE MINISTER OF FINANCE**

# MINISTRY OF FINANCE

## Consolidated Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Members of the Legislative Assembly**

I have audited the consolidated statement of financial position of the Ministry of Finance as at March 31, 2005 and the consolidated statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the management of the Ministry. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Ministry as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
May 20, 2005

Fred J. Dunn, FCA
Auditor General

MINISTRY OF FINANCE

## CONSOLIDATED STATEMENT OF OPERATIONS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | | 2004 |
|---|---|---|---|
| | **Budget (Schedule 2)** | **Actual** | **Restated Actual (Note 10)** |
| **Revenues** (Schedules 1 and 2) | | | |
| Income taxes | $ 7,041,956 | $ 7,012,664 | $ 6,308,958 |
| Other taxes | 1,492,481 | 1,612,326 | 1,550,087 |
| Transfers from Government of Canada | 4,055 | 4,178 | 4,100 |
| Net investment income | 1,204,269 | 1,786,526 | 1,812,227 |
| Net income from commercial operations | 155,837 | 193,380 | 200,183 |
| Premiums, fees and licences | 38,771 | 38,956 | 31,643 |
| Internal government transfers | 84,565 | 155,107 | 159,289 |
| Other | 49,236 | 49,346 | 43,819 |
| | 10,071,170 | 10,852,483 | 10,110,306 |
| **Expenses** (Schedules 2 and 3) | | | |
| Fiscal planning and financial management | 53,490 | 58,038 | 43,323 |
| Investment, treasury and risk management | 197,540 | 183,168 | 184,492 |
| Financial sector and pensions | 366,577 | 355,376 | 369,488 |
| Ministry support services | 10,540 | 10,584 | 9,964 |
| Valuation adjustments (Schedule 4) | (12,500) | 5,944 | 5,520 |
| Debt servicing costs | | | |
| General government | 302,000 | 241,487 | 201,613 |
| School boards | 53,020 | 53,011 | 61,493 |
| | 970,667 | 907,608 | 875,893 |
| **Net operating results** | $ 9,100,503 | $ 9,944,875 | $ 9,234,413 |

*The accompanying notes and schedules are part of these financial statements.*

MINISTRY OF FINANCE

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| **Assets** | | |
| Cash and temporary investments (Schedule 5) | $ 3,801,892 | $ 2,481,824 |
| Accrued interest and accounts receivable (Schedule 6) | 781,391 | 1,080,274 |
| Portfolio investments (Schedule 7) | 18,995,474 | 16,852,138 |
| Equity in commercial enterprises (Schedule 8) | 1,331,693 | 1,130,232 |
| Loans and advances to government entities (Schedule 9) | 1,301,258 | 1,337,116 |
| Other loans and advances (Schedule 10) | 4,204,188 | 4,084,201 |
| Tangible capital assets (Schedule 11) | 19,531 | 18,980 |
| | $ 30,435,427 | $ 26,984,765 |
| **Liabilities** | | |
| Bank overdraft | $ 942,671 | $ 786,928 |
| Accrued interest and accounts payable (Schedule 12) | 730,221 | 731,132 |
| Unmatured debt (Schedule 13) | 3,722,250 | 5,147,016 |
| Debt of Alberta Capital Finance Authority (Schedule 14) | 4,267,567 | 4,069,558 |
| Pension obligations (Schedule 15) | 971,233 | 964,692 |
| Other accrued liabilities (Schedule 16) | 459,165 | 534,350 |
| | 11,093,107 | 12,233,676 |
| **Net Assets** | | |
| Net assets at beginning of year | 14,751,089 | 10,180,504 |
| Net operating results | 9,944,875 | 9,234,413 |
| Net transfer to general revenues | (5,353,644) | (4,663,828) |
| Net assets at end of year | 19,342,320 | 14,751,089 |
| | $ 30,435,427 | $ 26,984,765 |

*The accompanying notes and schedules are part of these financial statements.*

MINISTRY OF FINANCE

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| **Operating activities** | | |
| Net operating results | $ 9,944,875 | $ 9,234,413 |
| Non-cash items included in net operating results | (370,801) | (510,034) |
| | 9,574,074 | 8,724,379 |
| Other | 291,490 | (81,827) |
| Cash provided by operating activities | 9,865,564 | 8,642,552 |
| **Capital activities** | | |
| Purchase of tangible capital assets | (6,670) | (7,127) |
| Proceeds from disposals of tangible capital assets | 38 | 6 |
| Cash used for capital activities | (6,632) | (7,121) |
| **Investing activities** | | |
| Proceeds from disposals, repayments and redemptions of portfolio investments | 6,618,986 | 7,655,404 |
| Portfolio investments purchased | (8,576,066) | (9,119,056) |
| Repayments of loans and advances | 497,221 | 553,084 |
| Loans and advances made | (569,139) | (541,871) |
| Cash used for investing activities | (2,028,998) | (1,452,439) |
| **Financing activities** | | |
| Debt issues | 5,909,214 | 13,952,981 |
| Debt retirement | (7,146,210) | (15,122,195) |
| Grants for school construction debenture principal repayment | (74,969) | (82,509) |
| Net transfer to general revenues | (5,353,644) | (4,663,828) |
| Cash used for financing activities | (6,665,609) | (5,915,551) |
| **Net cash provided** | 1,164,325 | 1,267,441 |
| **Cash and temporary investments, net of bank overdraft, at beginning of year** | 1,694,896 | 427,455 |
| **Cash and temporary investments, net of bank overdraft, at end of year** | $ 2,859,221 | $ 1,694,896 |

*The accompanying notes and schedules are part of these financial statements.*

MINISTRY OF FINANCE

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended March 31, 2005

## NOTE 1 AUTHORITY

The Minister of Finance has been designated as responsible for various Acts by the *Government Organization Act*, Chapter G-10, Revised Statutes of Alberta 2000, and its regulations. To fulfil these responsibilities, the Minister of Finance administers the organizations listed below. The authority under which each organization operates is also listed. Together, these organizations form the Ministry of Finance (the Ministry).

| | |
|---|---|
| Department of Finance (the Department) | *Government Organization Act*, Chapter G-10, Revised Statutes of Alberta 2000 |
| Alberta Heritage Foundation for Medical Research Endowment Fund | *Alberta Heritage Foundation for Medical Research Act*, Chapter A-21, Revised Statutes of Alberta 2000 |
| Alberta Heritage Savings Trust Fund | *Alberta Heritage Savings Trust Fund Act*, Chapter A-23, Revised Statutes of Alberta 2000 |
| Alberta Heritage Scholarship Fund | *Alberta Heritage Scholarship Act*, Chapter A-24, Revised Statutes of Alberta 2000 |
| Alberta Heritage Science and Engineering Research Endowment Fund | *Alberta Heritage Foundation for Science and Engineering Research Act*, Chapter A-22, Revised Statutes of Alberta 2000 |
| Alberta Risk Management Fund | *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 |
| Provincial Judges and Masters in Chambers Reserve Fund | Treasury Board Directive pursuant to the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 |
| Supplementary Retirement Plan Reserve Fund | Treasury Board Directive pursuant to the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 |
| Alberta Capital Finance Authority | *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000 |
| Alberta Insurance Council | *Insurance Act*, Chapter I-3, Revised Statutes of Alberta 2000 |
| Alberta Pensions Administration Corporation | Incorporated under the *Business Corporations Act*, Chapter B-9, Revised Statutes of Alberta 2000 |
| Alberta Securities Commission | Incorporated June 1, 1995 under the *Securities Act*, Chapter S-4, Revised Statutes of Alberta 2000 |

MINISTRY OF FINANCE

**NOTE 1 (continued)**

| | |
|---|---|
| The Alberta Government Telephones Commission and its subsidiaries | *Telecommunications Act*, Chapter T-3.5, Statutes of Alberta 1988 |
| Alberta Treasury Branches and its subsidiaries | *Alberta Treasury Branches Act*, Chapter A-37, Revised Statutes of Alberta 2000 |
| Credit Union Deposit Guarantee Corporation | *Credit Union Act,* Chapter C-32, Revised Statutes of Alberta 2000 |
| N.A. Properties (1994) Ltd. | Amalgamated corporation under the *Business Corporations Act*, Chapter B-9, Revised Statutes of Alberta 2000 |
| Gainers Inc. | Incorporated under the *Business Corporations Act*, Chapter B-9, Revised Statutes of Alberta 2000 |

## NOTE 2 PURPOSE

The Ministry's core businesses are:
**a)** fiscal planning and financial management,
**b)** investment, treasury and risk management,
**c)** regulation of financial institutions, capital market and pensions, and
**d)** financial services.

## NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. These financial statements are prepared in accordance with the following accounting policies.

**a) Method of Consolidation**

The accounts of the Department, the Alberta Heritage Foundation for Medical Research Endowment Fund, the Alberta Heritage Savings Trust Fund, the Alberta Heritage Scholarship Fund, the Alberta Heritage Science and Engineering Research Endowment Fund, the Alberta Risk Management Fund, Provincial Judges and Masters in Chambers Reserve Fund, Supplementary Retirement Plan Reserve Fund, Alberta Capital Finance Authority, Alberta Insurance Council, Alberta Pensions Administration Corporation and Alberta Securities Commission, are consolidated after adjusting them to a basis consistent with the accounting policies described below in (b). Intra-ministry transactions (revenues, expenses, capital, investing and financing transactions, and related asset and liability accounts) have been eliminated.

The accounts of Provincial agencies and other entities designated as commercial enterprises (The Alberta Government Telephones Commission and its subsidiaries, Alberta Treasury Branches and its subsidiaries, Credit Union Deposit Guarantee Corporation, and N.A. Properties (1994) Ltd.), and the commercial Crown-controlled corporation (Gainers Inc.) are reported on the modified equity basis, the equity being computed in accordance with generally accepted accounting principles.

MINISTRY OF FINANCE

**NOTE 3 (continued)**

The reporting period of some of the Provincial agencies is other than March 31. Transactions of these agencies that have occurred during the period to March 31, 2005 and that significantly affect the consolidation have been recorded.

**b) Basis of Financial Reporting**

**REVENUES**
All revenues are reported on the accrual method of accounting. Corporate income tax receipts from corporations in anticipation of an upward reassessment of Alberta income tax payable are described as corporate income tax receipts in abeyance and recorded as accounts payable.

**EXPENSES**
Expenses represent the cost of resources consumed during the year on Ministry operations. Expenses include amortization of tangible capital assets. Grants are recognized as expenses when authorized, eligibility criteria if any are met, and a reasonable estimate of the amounts can be made.

Pension costs included in these statements comprise the cost of employer contributions for current service of employees during the year and additional government and employer contributions for service relating to prior years.

Certain expenses, primarily for office space and legal advice, incurred on behalf of the Ministry by other ministries are not reflected in the consolidated statement of operations. Schedule 18 discloses information on these related party transactions.

**VALUATION ADJUSTMENTS**
Valuation adjustments include changes in the valuation allowances used to reflect financial assets at their net recoverable or other appropriate value. Valuation adjustments also represent the change in management's estimate of future payments arising from obligations relating to guarantees, indemnities, pension obligations, loans repayable from future appropriations, and accrued employee vacation entitlements.

Valuation adjustments for pension obligations include interest on the Ministry's share of the unfunded liability and amortization of deferred adjustments over the expected average remaining service life of employees.

**DERIVATIVE CONTRACTS**
Income and expense from derivative contracts are included in investment income or debt servicing costs. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the same period as the gains and losses of the specific assets and liabilities being hedged.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures contracts and forward foreign exchange contracts, are recorded at fair value.

MINISTRY OF FINANCE

**NOTE 3 (continued)**

The estimated amount receivable and payable from derivative contracts are included in accrued interest receivable and payable respectively.

**ASSETS**

Financial assets are limited to financial claims on outside organizations and individuals and inventories held for resale at the year end.

Portfolio investments are carried at cost. Cost includes amortization of discount or premium using the straight line method over the life of the investments. Realized gains and losses on disposals of these investments are included in the determination of net operating results for the year. Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

Loans are recorded at cost less any allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

Assets acquired by right are not included. Tangible capital assets of the Ministry are recorded at historical cost and amortized on a straight line basis over the estimated useful lives of the assets (see Schedule 11). The threshold for capitalizing new systems development is $100,000 and the threshold for all other capital assets is $5,000 (2004 $15,000).

**LIABILITIES**

Liabilities include all financial claims payable by the Ministry at the year end.

Debentures included in unmatured debt are recorded at the face amount of the issue less unamortized discount, which includes issue expenses and hedging costs.

Income or expense on interest rate swaps and forward interest rate agreements used to manage interest rate exposure is recorded as an adjustment to debt servicing costs. The exchange gain or loss on the foreign exchange contracts used to manage currency exposure is deferred and amortized over the life of the contract.

**FOREIGN CURRENCY**

Assets and liabilities denominated in foreign currency are translated at the year end rate of exchange.

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts.

Exchange gains and losses that arise on translation of fixed term foreign currency denominated monetary items are deferred and amortized over the life of the contract. Amortization of deferred exchange gains and losses and other exchange differences on unhedged transactions are included in the determination of net operating results for the year.

MINISTRY OF FINANCE

**NOTE 3 (continued)**

**MEASUREMENT UNCERTAINTY**

Estimates are used in accruing revenues and expenses in circumstances where the actual accrued revenues and expenses are unknown at the time the financial statements are prepared. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty that is material to these financial statements exists in the accrual of personal and corporate income taxes and provisions for pensions and loans and advances. The nature of the uncertainty in these items arises from several factors such as the effect on accrued taxes of the verification of taxable income, the effect on accrued pension obligations of actual experience compared to assumptions, and the effect on loans and advances of actual collectibility and changes in economic conditions. Personal income tax, recorded as $4,648,349,000 (2004 $4,612,531,000) in these consolidated financial statements, is subject to measurement uncertainty due primarily to the use of economic estimates of personal income growth. Use of this information in the past has resulted in a number that differs from final results by a geometric average of plus or minus $200 million over the last four years.

While best estimates have been used for reporting items subject to measurement uncertainty, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements.

## NOTE 4 VALUATION OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Due to their short term nature, the fair values of cash and temporary investments, accrued interest, receivables, bank overdraft, payables and other accrued liabilities are estimated to approximate their book values.

The methods used to determine the fair values of portfolio investments are explained in the following paragraphs.

Public fixed-income securities and equities are valued at the year-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Mortgages and certain non-public provincial debentures are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.

The fair value of alternative investments including absolute return strategy investments, investments in private investment funds, private equities and securities with limited marketability is estimated using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

MINISTRY OF FINANCE

**NOTE 4 (continued)**

Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

Fair values of loans and advances are not reported due to there being no organized financial market for the instruments and it is not practicable within constraints of timeliness or cost to estimate the fair values with sufficient reliability.

The fair value of unmatured debt and debt held by Alberta Capital Finance Authority is an approximation of its fair value to the holder.

The fair value of derivative contracts relating to portfolio investments is included in the fair value of portfolio investments.

The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest. Forward foreign exchange contracts and equity index futures contracts are valued based on quoted market prices. Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates. Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

At the year end, the fair values of investments and any other assets and liabilities denominated in a foreign currency are translated at the year end exchange rate.

## NOTE 5 RISK MANAGEMENT

**a) Liability Management**

The objective of the Ministry's liability management program is to achieve the lowest cost on debt within an acceptable degree of variability of debt servicing costs. In order to achieve this objective, the Ministry manages four risks: interest rate risk, currency exchange risk, credit risk, and refinancing risk. The Ministry manages these four risks within approved policy guidelines. The management of these risks and the policy guidelines apply to the Ministry’s unmatured debt, excluding debt raised to fund requirements of provincial corporations and regulated funds. Debt of provincial corporations and regulated funds is managed separately in relation to their assets.

The Ministry has decided, in light of the current debt reduction environment, that the most effective liability risk management strategy would be to allow existing debt instruments to mature in accordance with their terms.

MINISTRY OF FINANCE

**NOTE 5 (continued)**

**b) Asset Management**

The majority of the Ministry's portfolio investments are in the Alberta Heritage Savings Trust Fund (Heritage Fund). Income and financial returns are exposed to credit risk and price risk. Price risk is comprised of currency risk, interest rate risk and market risk. Risk is reduced through asset class diversification, quality constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets.

The investment objective is to invest in a diversified portfolio to maximize long-term returns at an acceptable level of risk. The policy asset mix for fixed income securities is 35%. The policy mix for public equity investment is 46%. The remainder of the portfolio is invested in real estate, private equities and absolute return strategies.

The investments in the Alberta Heritage Foundation for Medical Research Endowment Fund, the Alberta Heritage Scholarship Fund and the Alberta Heritage Science and Engineering Research Endowment Fund are managed to preserve the capital of the funds over the long term and to provide an annual level of income for the purpose of making grants to researchers in the fields of medicine, science and engineering, and to students.

The investments of the Department are used to repay debt as it matures, to provide funding for the capital plan, and to help protect operating and capital spending from short-term declines in revenue and the costs of emergencies, disasters, natural gas rebates and settlements with First Nations.

## NOTE 6 CONTRACTUAL OBLIGATIONS

*(thousands)*

Obligations to outside organizations in respect of contracts entered into before March 31, 2005 amounted to $247,105 (2004 $235,074). These amounts include obligations under operating leases which expire on various dates. The aggregate amounts payable for the unexpired terms of these leases are as follows:

| | |
|---|---|
| 2005-06 | $ 55,116 |
| 2006-07 | 51,398 |
| 2007-08 | 46,858 |
| 2008-09 | 36,860 |
| 2009-10 | 22,027 |
| Thereafter | 34,846 |
| | $ 247,105 |

## NOTE 7 CONTINGENT LIABILITIES

*(thousands)*

Set out below are details of contingent liabilities resulting from guarantees, indemnities and litigation, other than those reported as liabilities and shown in Schedule 16.

Any losses arising from the settlement of contingent liabilities are treated as current year expenses.

MINISTRY OF FINANCE

**NOTE 7 (continued)**

**a) Indemnities and Guarantees**

Guarantees at March 31, 2005 amounting to $16,951 (2004 $29,502) are analyzed in Schedule 17. This schedule is included with the financial statements because payments under guarantees are a statutory charge on the Ministry.

**b) Contingent Liabilities of Commercial Enterprises**

The Credit Union Deposit Guarantee Corporation has a potential liability under guarantees relating to deposits of credit unions. At December 31, 2004, credit unions in Alberta held deposits totalling $8,963,176 (2003 $8,240,449), and had assets in excess of deposits.

At March 31, 2005, Alberta Treasury Branches had a potential liability under guarantees and letters of credit amounting to $132,708 (2004 $107,786).

N.A. Properties (1994) Ltd. has provided guarantees of principal and interest on mortgages sold to Canadian Western Bank. The principal and interest on these mortgages totalled $2,058 at March 31, 2005 (2004 $2,239).

**c) Legal Actions**

At March 31, 2005, the Ministry is a defendant in various legal actions. The total claimed in specific legal actions amounts to approximately $3,813,056. The resulting loss, if any, from these claims cannot be determined. Included in this amount are claims for $3,750,000 in which the Ministry has been jointly named with other entities. The resulting loss, if any, from these claims cannot be determined.

## NOTE 8 TRUST FUNDS UNDER ADMINISTRATION

*(thousands)*

The Ministry administers trust funds that are regulated funds consisting of public money over which the Legislature has no power of appropriation. Because the Ministry has no equity in the funds and administers them for the purposes of various trusts, they are not included in the Ministry's consolidated financial statements.

As at March 31, 2005, trust funds under administration were as follows:

| | **2005** | **2004 Restated (Note 10)** |
|---|---|---|
| Local Authorities Pension Plan Fund | $ 11,121,963 | $ 10,068,470 |
| Public Service Pension Plan Fund | 4,550,299 | 4,235,063 |
| The Workers' Compensation Board Accident Fund | 2,606,800 | 2,328,797 |
| Universities Academic Pension Plan Fund | 1,928,313 | 1,808,091 |
| Management Employees Pension Plan Fund | 1,755,326 | 1,633,697 |
| Special Forces Pension Plan Fund | 1,175,418 | 1,102,139 |
| Regional Health Authorities and various health institutions construction accounts | 914,877 | 395,975 |
| Power Pool of Alberta Balancing Pool | 32,697 | 115,892 |
| Other | 136,173 | 88,565 |
| | $ 24,221,866 | $ 21,776,689 |

MINISTRY OF FINANCE

## NOTE 9 DEFINED BENEFIT PLANS

*(thousands)*

The Ministry participates in the multiemployer pension plans, Management Employees Pension Plan and Public Service Pension Plan. The Ministry also participates in the multiemployer Supplementary Retirement Plan for Public Service Managers. The expense for these plans is equivalent to the annual contributions of $4,190 for the year ended March 31, 2005 (2004 $3,844).

At December 31, 2004, the Management Employees Pension Plan reported a deficiency of $268,101 (2003 $290,014) and the Public Service Pension Plan reported a deficiency of $450,068 (2003 $584,213). At December 31, 2004, the Supplementary Retirement Plan for Public Service Managers had a surplus of $9,404 (2003 $9,312).

The Ministry also participates in two multiemployer Long Term Disability Income Continuance Plans. At March 31, 2005, the Bargaining Unit Plan reported an actuarial deficiency of $11,817 (2004 $9,766) and the Management, Opted Out and Excluded Plan an actuarial surplus of $3,208 (2004 $1,298). The expense for these two plans is limited to the employer's annual contributions for the year.

## NOTE 10 GOVERNMENT REORGANIZATION

*(thousands)*

As a result of government restructuring announced on November 24, 2004, the former Finance and Revenue Ministries have been merged into a single Finance Ministry. These financial statements are prepared on the basis as if the Ministry had always been assigned its current responsibilities.

Net assets (liabilities) as at March 31, 2004 and March 31, 2003 have been restated as follows:

| | March 31, 2004 | March 31, 2003 |
|---|---|---|
| Net assets (liabilities) as originally reported | | |
| Ministry of Finance | $ 1,080,346 | $ (3,147,261) |
| Ministry of Revenue | 13,670,743 | 13,327,765 |
| Net assets as restated | $ 14,751,089 | $ 10,180,504 |

## NOTE 11 COMPARATIVE FIGURES

Comparative figures have been restated to conform to 2005 presentation.

## NOTE 12 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Senior Financial Officer and the Deputy Minister.

MINISTRY OF FINANCE

# SCHEDULES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## REVENUES

**Schedule 1**

Year Ended March 31, 2005 *(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Restated Actual (Note 10) |
|---|---|---|---|
| Income taxes | | | |
| Personal income tax | $ 5,084,671 | $ 4,648,349 | $ 4,612,531 |
| Corporate income tax | 1,957,285 | 2,364,315 | 1,696,427 |
| | 7,041,956 | 7,012,664 | 6,308,958 |
| Other taxes | | | |
| Tobacco tax | 660,000 | 697,655 | 670,502 |
| Fuel tax | 607,000 | 640,918 | 619,585 |
| Insurance taxes | 164,731 | 209,716 | 203,492 |
| Hotel room tax | 60,000 | 61,021 | 53,325 |
| Special broker tax | 750 | 2,867 | 2,668 |
| Financial institutions capital tax | - | 149 | 515 |
| | 1,492,481 | 1,612,326 | 1,550,087 |
| Transfers from Government of Canada | | | |
| Unconditional subsidy | 4,055 | 4,178 | 4,100 |
| Net investment income | 1,204,269 | 1,786,526 | 1,812,227 |
| Net income from commercial operations | | | |
| Alberta Treasury Branches | 150,590 | 187,313 | 172,024 |
| Other | 5,247 | 6,067 | 28,159 |
| | 155,837 | 193,380 | 200,183 |
| Premiums, fees, and licences | | | |
| Alberta Securities Commission | 18,260 | 18,887 | 16,406 |
| Deposit guarantee fee | 16,585 | 15,785 | 11,836 |
| Insurance companies, agents and brokers | 2,467 | 2,755 | 1,859 |
| Other | 1,459 | 1,529 | 1,542 |
| | 38,771 | 38,956 | 31,643 |
| Internal government transfers | | | |
| Lottery Fund | 84,365 | 154,748 | 137,755 |
| Other | 200 | 359 | 21,534 |
| | 84,565 | 155,107 | 159,289 |
| Other | | | |
| Sale of assets | - | 10 | 3 |
| Refunds of expenditure | 500 | 465 | 183 |
| Service revenue | 13,631 | 11,986 | 9,444 |
| Insurance services | 8,106 | 7,622 | 6,590 |
| Miscellaneous | 26,999 | 29,263 | 27,599 |
| | 49,236 | 49,346 | 43,819 |
| | $ 10,071,170 | $ 10,852,483 | $ 10,110,306 |

MINISTRY OF FINANCE

## BUDGET

**Schedule 2**

Year Ended March 31, 2005 *(thousands)*

| | 2004-05 Estimates | Adjustments (a) | 2004-05 Budget | Authorized Supplementary (b) | 2004-05 Authorized Budget |
|---|---|---|---|---|---|
| Revenues | | | | | |
| Income taxes | $ 7,041,956 | $ - | $ 7,041,956 | $ - | $ 7,041,956 |
| Other taxes | 1,492,481 | - | 1,492,481 | - | 1,492,481 |
| Transfers from Government of Canada | 4,055 | - | 4,055 | - | 4,055 |
| Net investment income | 1,204,269 | - | 1,204,269 | - | 1,204,269 |
| Net income from commercial operations | 155,837 | - | 155,837 | - | 155,837 |
| Premiums, fees, and licences | 38,771 | - | 38,771 | - | 38,771 |
| Internal government transfers | 84,565 | - | 84,565 | - | 84,565 |
| Other | 49,236 | - | 49,236 | - | 49,236 |
| | 10,071,170 | - | 10,071,170 | - | 10,071,170 |
| Expenses | | | | | |
| Fiscal planning and financial management | 53,490 | - | 53,490 | - | 53,490 |
| Investment, treasury and risk management | 197,540 | - | 197,540 | - | 197,540 |
| Financial sector and pensions | 366,577 | - | 366,577 | 1,400 | 367,977 |
| Ministry support services | 10,540 | - | 10,540 | - | 10,540 |
| Valuation adjustments | 500 | (13,000) | (12,500) | - | (12,500) |
| Debt servicing costs | | | | | |
| General government | 302,000 | - | 302,000 | - | 302,000 |
| School boards | 53,020 | - | 53,020 | - | 53,020 |
| | 983,667 | (13,000) | 970,667 | 1,400 | 972,067 |
| Net operating results | $ 9,087,503 | $ 13,000 | $ 9,100,503 | $ (1,400) | $ 9,099,103 |

a) Adjustments consist of $13,000 for pension provisions excluded from the Estimates.

b) Supplementary Estimates were approved on March 24, 2005.

MINISTRY OF FINANCE

## EXPENSES BY OBJECT

Schedule 3

*(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Restated Actual (Note 10) |
|---|---|---|---|
| Salaries, wages and employee benefits | $ 66,796 | $ 70,339 | $ 62,548 |
| Supplies and services | 53,569 | 40,821 | 51,093 |
| Grants | 146,649 | 139,506 | 144,316 |
| Interest and amortization of unrealized exchange gains and losses | 614,720 | 545,219 | 520,669 |
| Pension liability funding | 73,700 | 71,002 | 69,172 |
| Corporate tax interest refunds | 20,000 | 27,358 | 15,641 |
| Valuation adjustments (Schedule 4) | (12,500) | 5,944 | 5,520 |
| Amortization of tangible capital assets | 6,167 | 6,082 | 5,356 |
| Other financial transactions | 1,630 | 1,421 | 1,651 |
| | 970,731 | 907,692 | 875,966 |
| Less recovery from support service arrangements with related parties (a) | 64 | 84 | 73 |
| | $ 970,667 | $ 907,608 | $ 875,893 |

a) The Ministry provides financial, administrative and human resource services to various ministries and Offices of the Legislative Assembly. Costs incurred by the Ministry are recovered from the recipients of the services.

## VALUATION ADJUSTMENTS

Schedule 4

*(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Restated Actual (Note 10) |
|---|---|---|---|
| Pension provisions | $ (13,000) | $ 6,541 | $ 2,445 |
| Provision for doubtful accounts and loans | 500 | (581) | 3,570 |
| Provision for employee benefits other than pensions | - | (20) | 471 |
| Provision for guarantees and indemnities | - | 4 | (966) |
| | $ (12,500) | $ 5,944 | $ 5,520 |

MINISTRY OF FINANCE

## CASH AND TEMPORARY INVESTMENTS — Schedule 5

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Fixed-income securities (a) | | |
| Government of Canada, direct and guaranteed | $ 144,666 | $ 431,770 |
| Provincial, direct and guaranteed | 129,585 | 39,850 |
| Corporate | 1,439,061 | 659,932 |
| Pooled investment funds | 14,757 | 12,386 |
| Canadian equities | | |
| Pooled investment funds | 4,977 | 4,818 |
| | 1,733,046 | 1,148,756 |
| Deposit in the Consolidated Cash Investment Trust Fund | 1,284,608 | 1,184,439 |
| Cash in bank and in transit | 784,238 | 148,629 |
| | $ 3,801,892 | $ 2,481,824 |

a) At March 31, 2005, fixed-income securities held have an average effective market yield of 2.7% (2004 2.2%) per annum. All (2004 98%) of the securities have terms to maturity of less than one year.

## ACCRUED INTEREST AND ACCOUNTS RECEIVABLE — Schedule 6

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Personal income tax | $ 265,486 | $ 346,065 |
| Accrued interest receivable | 238,223 | 218,913 |
| Lottery Fund | 68,422 | 52,756 |
| Fuel tax | 62,529 | 56,911 |
| Insurance taxes | 50,083 | 39,573 |
| Present value of future contributions from credit union system | 38,695 | 47,695 |
| Corporate income tax (a) | 37,275 | 291,935 |
| Tobacco tax | 6,024 | 16,992 |
| Hotel room tax | 5,437 | 4,851 |
| Financial institutions capital tax | 1,965 | 1,855 |
| Other | 10,731 | 6,761 |
| | 784,870 | 1,084,307 |
| Less allowance for doubtful accounts | 3,479 | 4,033 |
| | $ 781,391 | $ 1,080,274 |

a) During the year, the methodology used to estimate corporate income tax receivable was changed to include an estimated accrual for corporate income tax refunds payable based on a five year moving average.

MINISTRY OF FINANCE

## PORTFOLIO INVESTMENTS

**Schedule 7**

*(thousands)*

| | 2005 | | 2004 Restated (Note 10) | |
|---|---|---|---|---|
| | Book Value | Fair Value | Book Value | Fair Value |
| Fixed-income securities (a) (b) (c) | | | | |
| Government of Canada, direct and guaranteed | $ 558,153 | $ 559,391 | $ 987,038 | $ 992,521 |
| Provincial, direct and guaranteed | 2,218,264 | 2,227,197 | 1,000,396 | 1,006,801 |
| Municipal | 71,639 | 71,617 | 14,250 | 14,459 |
| Corporate | 3,360,124 | 3,356,610 | 2,060,381 | 2,071,659 |
| Pooled investment funds | 4,106,381 | 4,192,555 | 4,152,550 | 4,273,154 |
| | 10,314,561 | 10,407,370 | 8,214,615 | 8,358,594 |
| Equities (c) | | | | |
| Pooled investment funds | | | | |
| Canadian | 2,519,453 | 2,829,252 | 2,939,065 | 3,342,695 |
| Foreign | 4,329,856 | 4,616,336 | 4,145,054 | 4,584,224 |
| Real Estate | 1,137,888 | 1,341,128 | 974,955 | 1,062,957 |
| Absolute return strategies | 693,716 | 688,677 | 578,449 | 573,532 |
| | 8,680,913 | 9,475,393 | 8,637,523 | 9,563,408 |
| | $ 18,995,474 | $ 19,882,763 | $ 16,852,138 | $ 17,922,002 |

a) The majority of the Ministry's fixed-income securities are held by the Department to repay debt as it matures, to provide funding for the capital plan, and to help protect operating and capital spending from short-term declines in revenue and the costs of emergencies, disasters, natural gas rebates and settlements with First Nations. At March 31, 2005, the Department held $6,185 million (2004 $4,038 million) of public fixed-income securities at cost (Fair value $6,191 million (2004 $4,060 million)). The securities held have an average effective market yield of 3.4% (2004 2.3%) per annum. 65.8% (2004 77.3%) of the securities held had terms to maturity of less than two years.

b) Fixed-income securities are also held in the Alberta Heritage Savings Trust Fund (Heritage Fund). As at March 31, 2005, the Heritage Fund held $3,661 million (2004 $3,703 million) of public fixed-income securities at cost (Fair value $3,735 million (2004 $3,807 million)). The securities held have an average effective market yield of 4.5% (2004 4.4%) per annum and the following term structure based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| Under 1 year | 4 | 3 |
| 1 to 5 years | 35 | 38 |
| 6 to 10 years | 32 | 29 |
| 11 to 20 years | 12 | 11 |
| Over 20 years | 17 | 19 |
| | 100 | 100 |

MINISTRY OF FINANCE

**SCHEDULE 7 (continued)**

c) The Ministry uses derivative contracts to enhance return, hedge risks, and manage asset mix. As at March 31, 2005, the notional amount of all derivative contracts issued by the Ministry relating to portfolio investments amounted to $4,613 million (2004 $3,308 million). 64% (2004 68%) of these contracts mature within one year. As at March 31, 2005, all derivative contracts taken together had a net positive fair value of $21 million (2004 negative fair value of $89 million).

The following is a summary of the notional amount of derivative contracts held at March 31, 2005. The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Ministry attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Equity index swap contracts | $ 1,761,100 | $ 1,283,800 |
| Forward foreign exchange contracts | 1,061,900 | 667,700 |
| Cross-currency interest rate swaps | 663,500 | 452,500 |
| Interest rate swap contracts | 565,400 | 786,300 |
| Other | 561,000 | 117,800 |
| | $ 4,612,900 | $ 3,308,100 |

MINISTRY OF FINANCE

## EQUITY IN COMMERCIAL ENTERPRISES — Schedule 8

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Accumulated surpluses | | |
| Accumulated surpluses at beginning of year | $ 1,056,810 | $ 878,122 |
| Total revenue | 861,407 | 901,846 |
| Total expense | 668,027 | 701,740 |
| Net revenue | 193,380 | 200,106 |
| Net transfers to departments | - | (21,418) |
| Accumulated surpluses at end of year | $ 1,250,190 | $ 1,056,810 |
| Represented by | | |
| Assets | | |
| Loans | $ 13,137,917 | $ 12,131,053 |
| Investments | 1,029,285 | 944,399 |
| Other assets | 1,328,589 | 1,337,946 |
| Total assets | 15,495,791 | 14,413,398 |
| Liabilities | | |
| Accounts payable | 339,850 | 276,052 |
| Deposits | 13,840,032 | 13,035,120 |
| Unmatured debt | 65,719 | 45,416 |
| Total liabilities | 14,245,601 | 13,356,588 |
| | $ 1,250,190 | $ 1,056,810 |
| Accumulated surpluses at end of year | | |
| Alberta Treasury Branches | $ 1,150,274 | $ 962,961 |
| Credit Union Deposit Guarantee Corporation | 98,293 | 92,410 |
| N.A. Properties (1994) Ltd. | 1,623 | 1,439 |
| | 1,250,190 | 1,056,810 |
| Elimination of inter fund/agency balances | 81,503 | 73,422 |
| Equity in commercial enterprises at end of year | $ 1,331,693 | $ 1,130,232 |

MINISTRY OF FINANCE

## LOANS AND ADVANCES TO GOVERNMENT ENTITIES — Schedule 9

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Agriculture Financial Services Corporation | $ 899,750 | $ 911,867 |
| Alberta Social Housing Corporation | 401,284 | 425,025 |
| Public Trustee | 224 | 224 |
| | $ 1,301,258 | $ 1,337,116 |

## OTHER LOANS AND ADVANCES — Schedule 10

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Alberta Capital Finance Authority (a) | $ 4,093,860 | $ 3,961,104 |
| Alberta Heritage Savings Trust Fund Act | 185,815 | 181,559 |
| Farm Credit Stability Act | 14,445 | 25,878 |
| Board of Governors of the University of Alberta | 1,292 | 1,663 |
| Pratt & Whitney Canada Ltd. | 851 | 1,407 |
| University of Lethbridge Students' Union | 422 | 611 |
| Implemented guarantees and indemnities | 144 | 201 |
| Judgement debts | 47 | 51 |
| Accountable advances | 20 | 395 |
| | 4,296,896 | 4,172,869 |
| Less allowance for doubtful loans, advances, implemented guarantees and indemnities | 92,708 | 88,668 |
| | $ 4,204,188 | $ 4,084,201 |

a) Municipal loans on average yield 7.2% per annum (2004 7.8%) and have the following term structure as at March 31, 2005.

| | 2005 % | 2004 % |
|---|---|---|
| Under 1 year | 12 | 1 |
| 1 to 5 years | 36 | 21 |
| 6 to 10 years | 25 | 31 |
| Over 10 years | 27 | 47 |
| | 100 | 100 |

Interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt (see Schedule 14) made after January 1, 2004. As at March 31, 2005, the notional amount of all derivative contracts issued by the Ministry relating to loans and related debt amounted to $1,315 million (2004 $nil). 27% (2004 0%) of these contracts mature within one year. As at March 31, 2005, all derivative contracts taken together had a net negative fair value of $1.6 million (2004 $nil). The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value).

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## TANGIBLE CAPITAL ASSETS Schedule 11

*(thousands)*

| | Estimated Useful Life | 2005 Cost | 2005 Accumulated Amortization | 2005 Net Book Value | 2004 Restated (Note 10) Net Book Value |
|---|---|---|---|---|---|
| Equipment | 10 years | $ 3,366 | $ 1,166 | $ 2,200 | $ 708 |
| Computer hardware and software | 5 years | 36,734 | 20,723 | 16,011 | 16,814 |
| Other | 10 years | 2,448 | 1,128 | 1,320 | 1,458 |
| | | $ 42,548 | $ 23,017 | $ 19,531 | $ 18,980 |

## ACCRUED INTEREST AND ACCOUNTS PAYABLE Schedule 12

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Accrued interest on unmatured debt and debt of Alberta Capital Finance Authority | $ 185,888 | $ 232,507 |
| Corporate income tax receipts in abeyance | 364,942 | 345,925 |
| Unearned revenue | 814 | 726 |
| Other | 178,577 | 151,974 |
| | $ 730,221 | $ 731,132 |

MINISTRY OF FINANCE

## UNMATURED DEBT

**Schedule 13**

*(thousands)*

| | Effective Rate (a)(b)(c) % | Modified Duration (d) years | 2005 Book Value (a) | 2005 Fair Value (a) | 2004 Restated (Note 10) Book Value (a) | 2004 Restated (Note 10) Fair Value (a) |
|---|---|---|---|---|---|---|
| Canadian dollar debt and fully hedged foreign currency debt | | | | | | |
| Floating rate and short-term fixed rate (e) | 5.25 | 0.42 | $1,307,481 | $1,313,269 | $1,486,133 | $1,511,606 |
| Fixed rate long-term (f) | 6.92 | 4.22 | 2,284,613 | 2,601,025 | 2,932,683 | 3,429,457 |
| | 6.31 | 2.94 | 3,592,094 | 3,914,294 | 4,418,816 | 4,941,063 |
| Unhedged U.S. dollar debt (g) | | | | | | |
| Floating rate and short-term fixed rate (e) | 3.75 | 0.32 | 130,156 | 122,999 | 680,239 | 694,077 |
| Fixed rate long-term | - | - | - | - | 47,961 | 52,941 |
| | 3.75 | 0.32 | 130,156 | 122,999 | 728,200 | 747,018 |
| Total unmatured debt | 6.22 | 2.86 | $3,722,250 | $4,037,293 | $5,147,016 | $5,688,081 |

a) Book value represents the amount the Ministry owes. Fair value is an approximation of market value to the holder. The book value, fair value and weighted average effective rate include the effect of interest rate and currency rate swaps. Effective rate is the rate that exactly discounts estimated future cash payments through the expected term of the debt to the net carrying amount. For non-marketable issues, the effective rate and fair value are determined by reference to yield curves for comparable quoted issues.

b) Weighted average effective rates on unhedged U.S. dollar debt are based upon debt stated in U.S. dollars.

c) Weighted average effective rate on total unmatured debt is on debt inclusive of deferred exchange losses on unhedged U.S. dollar debt (see note (g)).

d) Modified duration is the weighted average term to maturity of the security's cash flows (i.e., interest and principal) and is a measure of price volatility; the greater the modified duration of a bond, the greater its percentage price volatility.

e) Floating rate debt includes short-term debt, term debt with less than one year remaining to maturity, and term debt with interest rate reset within a year.

f) Canadian dollar fixed rate debt includes $678,696 (2004 $678,696) held by the Canada Pension Plan Investment Fund.

g) U.S. dollar debt includes the Ministry's effective exposure to U.S. dollars through cross currency swaps totalling $107,600 U.S. at March 31, 2005. Unhedged U.S. dollar debt is translated into Canadian dollars at the March 31 noon exchange rate of $1.21 per U.S. dollar (2004 $1.31 per U.S. dollar). Deferred exchange gains on unhedged U.S. dollar debt amounted to $5,879 at March 31, 2005 (2004 $4,653). Amortization of deferred exchange gains amounted to $1,420 for the year ended March 31, 2005 (2004 $146,260). In Budget 2004, a change in the exchange rate of one U.S. cent to the Canadian dollar was estimated to have a $6 million effect on debt servicing costs.

MINISTRY OF FINANCE

**Schedule 13** (continued)

Debt principal repayment requirements at par in each of the next five years, including short-term debt maturing in 2005-06, and thereafter are as follows:

*(thousands)*

| | Total in Canadian Dollars | Unhedged in US Dollars |
|---|---|---|
| 2005-06 | $ 1,355,119 | $ 107,600 |
| 2006-07 | 149,379 | - |
| 2007-08 | 273,428 | - |
| 2008-09 | 730,679 | - |
| 2009-10 | 78,342 | - |
| Thereafter to 2016-17 | 1,144,171 | - |
| | $ 3,731,118 | $ 107,600 |

None of the debt has call provisions (2004 none).

**Derivative financial instruments**

The Ministry uses interest rate swaps and currency rate swaps and contracts to manage the interest rate risk and currency exposure associated with unmatured debt. In addition, forward interest rate agreements are used to manage interest rate exposure in the short term. Associated with these instruments are credit risks that could expose the Ministry to potential losses. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Credit exposure to counterparties is a fraction of the notional principal amount, as shown in the table below. The Ministry minimizes its credit risk associated with these contracts by dealing with only credit worthy counterparties.

Interest rate swaps involve the exchange of a series of interest payments, either at a fixed or floating rate, based upon a contractual or notional principal amount. An interest rate swap agreement based upon a notional amount involves no exchange of underlying principal. The notional amount serves as the basis for determining the exchange of interest payments. At March 31, 2005, interest rate swap agreements were being used primarily to convert fixed interest rate payments to floating rates.

Cross currency interest rate swaps involve both the swapping of interest rates and currencies.

MINISTRY OF FINANCE

**Schedule 13** (continued)

The following table summarizes the Ministry's derivative portfolio and related credit exposure. Notional amount represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows. Replacement cost represents the cost of replacing, at current market rates, all contracts which have a positive fair value.

*(thousands)*

| | 2005 | | 2004 Restated (Note 10) | |
|---|---|---|---|---|
| | Notional Amount | Replacement Cost | Notional Amount | Replacement Cost |
| Interest rate swaps | $825,000 | $ 25,825 | $1,131,000 | $ 50,394 |
| Cross currency interest rate swaps | 173,905 | 21,365 | 498,173 | 29,727 |
| | $998,905 | $ 47,190 | $1,629,173 | $ 80,121 |

MINISTRY OF FINANCE

## DEBT OF ALBERTA CAPITAL FINANCE AUTHORITY — Schedule 14

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Alberta Capital Finance Authority | | |
| Canadian dollar fixed rate debt (a) | $ 4,267,567 | $ 4,069,558 |

a) Canadian dollar fixed rate debt includes $2,204,567 (2004 $2,465,058) held by the Canada Pension Plan Investment Fund and has the following characteristics as at March 31, 2005 (see Schedule 13 note (a)).

| | 2005 | 2004 |
|---|---|---|
| Fair value | $4,699,000 | $4,544,000 |
| Effective rate per annum | 7.3% | 8.1% |

Interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans (see Schedule 10) and related debt made after January 1, 2004.

Debt principal repayment requirements in each of the next five years, including short-term debt maturing in 2005-06 and thereafter are as follows:

| | |
|---|---|
| 2005-06 | $ 423,604 |
| 2006-07 | 395,396 |
| 2007-08 | 351,383 |
| 2008-09 | 259,294 |
| 2009-10 | 470,523 |
| Thereafter | 2,367,367 |
| | $ 4,267,567 |

MINISTRY OF FINANCE

## PENSION OBLIGATIONS

**Schedule 15**

The Ministry has pension obligations in respect of public sector pension plans as described below.

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Obligations to pension plans for current and former employees and Members of the Legislative Assembly | | |
| Public Service Management (Closed Membership) Pension Plan (a) | $ 656,274 | $ 675,856 |
| Members of the Legislative Assembly Pension Plan (b) | 46,770 | 49,625 |
| Management Employees Pension Plan (a) | 12,349 | - |
| Public Service Pension Plan (a) | 8,181 | - |
| | 723,574 | 725,481 |
| Obligations to pension plans for employees of organizations outside the government reporting entity | | |
| Universities Academic Pension Plan (c) | 184,760 | 171,501 |
| Special Forces Pension Plan (c) | 62,899 | 67,710 |
| | 247,659 | 239,211 |
| | $ 971,233 | $ 964,692 |

a) The Ministry administers three defined benefit pension plans for substantially all of the government's employees. The three plans are the Public Service Management (Closed Membership), Management Employees and the Public Service pension plans. An employee can be a member of only one plan at a time. The Ministry also administers the Supplementary Retirement Plan for Public Service Managers.

The Public Service Management (Closed Membership) pension plan provides benefits to former members of the Public Service Management pension plan who were retired, were entitled to receive a deferred pension or had attained 35 years of service before August 1, 1992. The costs of all benefits under the plan are paid by the Ministry.

For Management Employees, the unfunded liability as determined by an actuarial valuation as at December 31, 2003 is being financed by a special payment of 6.8% of pensionable earnings shared between employees and employers as required to eliminate the unfunded liability over the period ending on or before December 31, 2018. As sponsor of the Plan, the Ministry records the Government's share of the employer's estimated accrued benefit liability. Current services costs are funded by employers and employees.

For Public Service, the unfunded liability as determined by an actuarial valuation as at December 31, 2002 is being financed by a special payment of 2.76% of pensionable earnings shared equally between employees and employers as required to eliminate the unfunded liability over the period ending on or before December 31, 2017. As sponsor of the Plan, the Ministry records the Government's share of the employer's estimated accrued benefit liability. Current service costs are funded by employers and employees.

b) The Ministry has a liability for payment of pension benefits under a defined benefit pension plan for Members of the Legislative Assembly. Active participation in this plan was terminated as of June 1993, and no benefits can be earned for service after this date.

MINISTRY OF FINANCE

**Schedule 15 (continued)**

c) Under the *Public Sector Pension Plans Act*, the Ministry has obligations for payment of additional contributions under defined benefit pension plans for certain employees of post-secondary educational institutions and municipalities. The plans are the Universities Academic and Special Forces plans.

For Universities Academic, the unfunded liability for service credited prior to January 1, 1992 is being financed by additional contributions of 1.25 per cent of pensionable salaries by the Ministry, and contributions by employers and employees to fund the remaining amount, as determined by the plan valuation, over the period ending on or before December 31, 2043. Current service costs are funded by employers and employees.

For Special Forces, the unfunded liability for service credited prior to January 1, 1992 is being financed by additional contributions in the ratio of 45.45 per cent by the Ministry and 27.27 per cent each by employers and employees, over the period ending on or before December 31, 2036. Current service costs are funded by employers and employees. The Act provides that payment of all benefits arising from pensionable service prior to 1994, excluding post-1991 cost of living adjustment benefits, is guaranteed by the Province.

Pension obligations are based upon actuarial valuations performed at least triennially using the projected benefit method prorated on services. The assumptions used in the valuations were adopted after consultation among the pension plan boards, the government and the actuaries, depending on the plan, and represent best estimates of future events. Each plan's future experience will inevitably vary, perhaps significantly, from the assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations. Gains and losses are amortized over the expected average remaining service lives of the related employee groups.

Information about the economic assumptions used in the most recent actuarial valuations is provided below for each plan. Demographic assumptions used in the valuations reflect the experience of the plans.

| Plan | Latest Valuation | Real Rate of Return % | Inflation Rate % | Investment Rate of Return % |
|---|---|---|---|---|
| Public Service Management (Closed Membership) Pension Plan | December 31, 2002 | 3.0 | 3.0 | 6.0 |
| Management Employees Pension Plan | December 31, 2003 | 4.0 | 2.75 | 6.75 |
| Public Service Pension Plan | December 31, 2002 | 3.75 | 3.25 | 7.0 |
| Members of the Legislative Assembly Pension Plan | March 31, 2003 | 3.0 | 3.0 | 6.0 |
| Universities Academic Pension Plan | December 31, 2004 | 4.0 | 2.75 | 6.75 |
| Special Forces Pension Plan | December 31, 2001 | 3.75 | 3.25 | 7.0 |

These actuarial valuations indicated a deficiency of net assets over actuarial present value of accrued benefits. Including deferred losses of $354.9 million (2004 $369.2 million), unfunded liabilities were extrapolated to March 31, 2005.

A separate pension plan fund is maintained for each pension plan except for the Members of the Legislative Assembly plan. Pension plan fund assets are invested in both marketable investments of organizations external to the government and in Province of Alberta bonds and promissory notes.

MINISTRY OF FINANCE

## OTHER ACCRUED LIABILITIES — Schedule 16

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Future funding to school boards to enable them to repay debentures issued to the Alberta Capital Finance Authority | $ 450,657 | $ 525,626 |
| Guarantees and indemnities (Schedule 17) | 2,550 | 2,550 |
| Vacation entitlements | 5,625 | 5,829 |
| Other | 333 | 345 |
| | $ 459,165 | $ 534,350 |

## GUARANTEES (a) — Schedule 17

*(thousands)*

| | 2005 | 2004 Restated (Note 10) | Expiry Date |
|---|---|---|---|
| Farm Credit Stability Act (b) | $ 15,175 | $ 27,081 | 2011 |
| Securities Act | 2,160 | 2,160 | Ongoing |
| Centre for Engineering Research Inc. | 792 | 1,149 | 2005 |
| University of Calgary | 1,004 | 1,071 | 2016 |
| Rural utilities loans | 370 | 591 | 2015 |
| | 19,501 | 32,052 | |
| Less estimated liability (Schedule 16) | 2,550 | 2,550 | |
| | $ 16,951 | $ 29,502 | |

a) Authorized loan guarantee limits decline as guaranteed loans are repaid.

The lender takes appropriate security prior to issuing a loan to the borrower which is guaranteed by the Province. The security taken depends on the nature of the loan. Interest rates are negotiated with the lender by the borrower and typically range from prime to prime plus two per cent.

No new program guarantees are being issued under the following Acts: Farm Credit Stability Act and the Rural Utilities Act.

b) The expiry date shown is the latest expiry date for guaranteed loans under the program.

MINISTRY OF FINANCE

## RELATED PARTY TRANSACTIONS Schedule 18

Related parties are those entities consolidated in the Province of Alberta's financial statements. Related parties also include management of the Ministry.

The Ministry is responsible for managing cash transactions of all departments and their funds. As a result, the Ministry engages in transactions with all other ministries in the normal course of operations.

The Ministry and its employees paid or collected certain taxes and fees set by regulation for permits, licences and other charges. These amounts were incurred in the normal course of business, reflect charges applicable to all users, and have been excluded from this Schedule.

The Ministry had the following transactions with related parties recorded at the amount of consideration agreed upon between the related parties.

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Revenues | | |
| Transfers | $ 155,107 | $ 159,289 |
| Interest | 81,377 | 85,911 |
| Charges for services | 6,743 | 6,615 |
| | $ 243,227 | $ 251,815 |
| Expenses | | |
| Transfers | $ 23,029 | $ 22,264 |
| Cost of services | 6,106 | 6,057 |
| | $ 29,135 | $ 28,321 |
| Assets | | |
| Accounts receivable | $ 69,468 | $ 54,099 |
| Accrued interest receivable | 18,683 | 21,124 |
| Loans and advances | 1,301,034 | 1,336,892 |
| | $ 1,389,185 | $ 1,412,115 |
| Liabilities | | |
| Accounts and accrued interest payable | $ - | $ 46 |

The above transactions do not include support service arrangement transactions disclosed in Schedule 3.

The Ministry also had the following transactions with related parties for which no consideration was exchanged. The amounts for these related party transactions are estimated based on the costs incurred by the service provider to provide the service. These amounts are not recorded in the financial statements and are mainly allocated to the fiscal planning and financial management and the investment, treasury and risk management programs administered by the Department of Finance.

*(thousands)*

| | 2005 | 2004 Restated (Note 10) |
|---|---|---|
| Expenses - incurred by others | | |
| Accommodation | $ 2,965 | $ 2,965 |
| Legal services | 2,059 | 1,993 |
| | $ 5,024 | $ 4,958 |

# DEPARTMENT OF FINANCE

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the statement of financial position of the Department of Finance as at March 31, 2005 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the management of the Department. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Department as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

DEPARTMENT OF FINANCE

## STATEMENT OF OPERATIONS

Year Ended March 31, 2005 *(thousands)*

| | Budget (Schedule 4) | 2005 Actual | 2004 Actual Restated (Note 3) |
|---|---|---|---|
| **Revenues (Schedule 1)** | | | |
| Internal government transfers | $ 728,606 | $ 1,246,651 | $ 1,271,239 |
| Income taxes | 7,041,956 | 7,012,664 | 6,308,958 |
| Other taxes | 1,492,481 | 1,612,327 | 1,550,087 |
| Transfers from Government of Canada | 4,055 | 4,178 | 4,100 |
| Investment income | 191,144 | 263,750 | 224,006 |
| Fees, permits and licences | 18,044 | 17,314 | 13,378 |
| Transfers from government enterprises | - | - | 21,495 |
| Other | 20,122 | 20,383 | 15,295 |
| | 9,496,408 | 10,177,267 | 9,408,558 |
| **Expenses - directly incurred (Note 2 (B) and Schedule 21)** | | | |
| Voted (Schedules 3 and 5) | | | |
| Ministry support services | 9,246 | 9,739 | 9,367 |
| Fiscal planning and accountability | 9,286 | 8,251 | 7,679 |
| Pensions, insurance and financial institutions | 3,919 | 5,950 | 5,023 |
| Treasury management | 2,732 | 2,151 | 2,426 |
| Long term revenue and investment policy | 1,797 | 846 | 609 |
| Revenue collection and rebates | 23,864 | 22,589 | 20,134 |
| Investment | 17,574 | 14,977 | 12,401 |
| Risk management and insurance | 1,202 | 1,212 | 1,162 |
| Debt servicing costs - school construction | 53,020 | 53,011 | 61,493 |
| | 122,640 | 118,726 | 120,294 |
| Statutory (Schedules 3 and 5) | | | |
| Interest payments on corporate tax refunds | 20,000 | 27,358 | 15,641 |
| Farm credit stability program | 300 | 292 | 501 |
| Pension liability funding | 73,700 | 71,045 | 69,242 |
| Debt servicing costs | 302,000 | 243,072 | 204,352 |
| Valuation adjustments (Schedule 6) | (12,500) | 5,944 | 5,520 |
| | 383,500 | 347,711 | 295,256 |
| Loss on disposal of tangible capital assets | - | - | 62 |
| | 506,140 | 466,437 | 415,612 |
| **Net Operating Results** | $ 8,990,268 | $ 9,710,830 | $ 8,992,946 |

*The accompanying notes and schedules are part of these financial statements.*

DEPARTMENT OF FINANCE

## STATEMENT OF FINANCIAL POSITION

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| **Assets** | | |
| Cash and temporary investments (Schedule 8) | $ 3,446,156 | $ 2,142,990 |
| Accounts and accrued interest receivable (Schedule 9) | 775,508 | 1,148,546 |
| Portfolio investments (Schedule 10) | 6,185,113 | 4,081,865 |
| Loans and advances to government entities (Schedule 11) | 1,212,918 | 1,242,460 |
| Other loans, advances and investments (Schedule 12) | 18,699 | 31,436 |
| Tangible capital assets (Schedule 13) | 8,853 | 9,139 |
| | $ 11,647,247 | $ 8,656,436 |
| **Liabilities** | | |
| Bank overdraft | $ 942,671 | $ 786,928 |
| Accounts and accrued interest payable (Schedule 14) | 498,005 | 483,401 |
| Unmatured debt (Schedule 15) | 3,722,250 | 5,190,416 |
| Pension obligations (Schedule 16) | 971,233 | 964,692 |
| Other accrued liabilities (Schedule 17) | 457,924 | 533,021 |
| | 6,592,083 | 7,958,458 |
| **Net Assets (Liabilities)** | | |
| Net assets (liabilities) at beginning of year, as restated (Note 3) | 697,978 | (3,631,140) |
| Net operating results | 9,710,830 | 8,992,946 |
| Net transfer to general revenues | (5,353,644) | (4,663,828) |
| Net assets at end of year | 5,055,164 | 697,978 |
| | $ 11,647,247 | $ 8,656,436 |

*The accompanying notes and schedules are part of these financial statements.*

DEPARTMENT OF FINANCE

## STATEMENT OF CASH FLOWS

Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| **Operating transactions** | | |
| Net operating results | $ 9,710,830 | $ 8,992,946 |
| Non-cash items included in net operating results | | |
| Amortization on investments and debt, net | | |
| Purchase and issue discounts | 35,639 | (9,225) |
| Foreign exchange gain | (1,443) | (146,735) |
| Net (income) loss on investments valued at equity | (184) | 547 |
| Amortization of tangible capital assets (Schedule 3) | 2,695 | 2,395 |
| Loss on disposal of tangible capital assets | - | 62 |
| Valuation adjustments (Schedule 6) | 5,944 | 5,520 |
| | 9,753,481 | 8,845,510 |
| Decrease (increase) in receivables | 373,611 | (263,502) |
| Increase (decrease) in payables | 16,500 | (19,449) |
| Cash provided by operating transactions | 10,143,592 | 8,562,559 |
| **Capital transactions** | | |
| Purchase of tangible capital assets (Schedule 5) | (2,444) | (4,261) |
| Proceeds from disposal of tangible capital assets | 35 | 6 |
| Cash used for capital transactions | (2,409) | (4,255) |
| **Investing transactions** | | |
| Disposals of portfolio investments | 3,526,809 | 6,126,705 |
| Portfolio investments purchased | (5,660,256) | (7,142,110) |
| Repayments of loans and advances | | |
| Government entities | 1,999,464 | 2,365,527 |
| Other | 13,454 | 18,941 |
| Loans and advances | | |
| Government entities | (1,966,713) | (2,258,152) |
| Other | (16) | (725) |
| Cash used for investing transactions | (2,087,258) | (889,814) |
| **Financing transactions** | | |
| Debt issues | 5,258,730 | 10,774,743 |
| Debt retirement | (6,736,619) | (12,396,100) |
| Voted non-budgetary disbursements to settle obligations (Schedule 5) | (74,969) | (82,509) |
| Net transfer to general revenues | (5,353,644) | (4,663,828) |
| Cash used for financing transactions | (6,906,502) | (6,367,694) |
| **Net cash provided** | 1,147,423 | 1,300,796 |
| **Cash and temporary investments, net of bank overdraft, at beginning of year** | 1,356,062 | 55,266 |
| **Cash and temporary investments, net of bank overdraft, at end of year** | $ 2,503,485 | $ 1,356,062 |

*The accompanying notes and schedules are part of these financial statements.*

DEPARTMENT OF FINANCE

# NOTES TO THE FINANCIAL STATEMENTS

Year Ended March 31, 2005 *(thousands)*

## NOTE 1 AUTHORITY AND PURPOSE

The Department of Finance (the Department) operates under the authority of the *Government Organization Act*, Chapter G-10, Revised Statutes of Alberta 2000.

The Department's core businesses are fiscal planning and financial management; regulation of provincial financial institutions; pensions policy, regulation and administration; financial services; long-term revenue and investment policy; manage revenue programs; manage and invest financial assets; manage risk associated with liability exposure and loss of public assets; and regulation and fostering of Alberta's capital market.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. These financial statements are prepared in accordance with the following accounting policies that have been established by government for all departments.

### a) Reporting Entity

The reporting entity is the Department, which is part of the Ministry of Finance and for which the Minister of Finance is accountable. Other entities reporting to the Minister of Finance are the Alberta Heritage Savings Trust Fund, the Alberta Heritage Foundation for Medical Research Endowment Fund, the Alberta Heritage Scholarship Fund, the Alberta Science and Engineering Research Endowment Fund, the Alberta Risk Management Fund, the Alberta Securities Commission, the Provincial Judges and Masters in Chambers Reserve Fund, the Supplementary Retirement Plan Reserve Fund, the Alberta Capital Finance Authority, the Alberta Insurance Council, the Alberta Pensions Administration Corporation, the Alberta Government Telephones Commission and its subsidiaries, the Alberta Treasury Branches and its subsidiaries, the Credit Union Deposit Guarantee Corporation, N.A. properties (1994) Ltd. and Gainers Inc. The activities of these organizations are not included in these financial statements.

The Ministry Annual Report provides a more comprehensive accounting of the financial position and results of operations for which the Minister of Finance is accountable.

All departments of the Government of Alberta operate within the General Revenue Fund (the Fund). The Minister of Finance administers the Fund. All cash receipts of departments are deposited into the Fund and all cash disbursements made by departments are paid from the Fund. Net transfer to general revenues is the difference between all cash deposits by other departments and all cash disbursements made on their behalf by the Department of Finance.

### b) Basis of Financial Reporting

**REVENUES**

All revenues are reported on the accrual method of accounting. Corporate income tax receipts from corporations in anticipation of an upward reassessment of Alberta income tax payable are described as corporate income tax receipts in abeyance and recorded as accounts payable.

DEPARTMENT OF FINANCE

**NOTE 2 (continued)**

**INTERNAL GOVERNMENT TRANSFERS**

Internal government transfers are transfers between entities within the government reporting entity where the entity making the transfer does not receive any goods or services directly in return.

**DEDICATED REVENUE**

Dedicated revenue initiatives provide a basis for authorizing spending. Dedicated revenues must be shown as credits or recoveries in the details of the Government Estimates for a supply vote. If actual dedicated revenues are less than budget and total voted expenses are not reduced by an amount sufficient to cover the deficiency in dedicated revenues, the following year's voted expenses are encumbered. If actual dedicated revenues exceed budget, the Department may, with the approval of the Treasury Board, use the excess revenue to fund additional expenses on the program. Schedule 2 discloses information on the Department's dedicated revenue initiatives.

**EXPENSES**

**Directly Incurred**

Directly incurred expenses are those costs the Department has primary responsibility and accountability for, as reflected in the government's budget documents.

In addition to program operating expenses such as salaries, supplies, etc., directly incurred expenses also include:

- amortization of tangible capital assets.
- pension costs, which comprise the cost of employer contributions for current service of employees during the year and additional government contributions for service relating to prior years.
- valuation adjustments, which include changes in the valuation allowances used to reflect financial assets at their net recoverable or other appropriate value. Valuation adjustments also represent the change in management's estimate of future payments arising from obligations relating to guarantees, indemnities, pension obligations, loans repayable from future appropriations, and accrued employee vacation entitlements.
- grants are recognized when authorized and eligibility criteria are met.

**Incurred by Others**

Services contributed by other entities in support of the Department's operations are disclosed in Schedule 21.

**ASSETS**

Financial assets of the Department are limited to financial claims, such as advances to and receivables from other organizations, employees and other individuals.

Portfolio investments are carried at cost. Cost includes amortization of discount or premium using the straight-line method over the life of the investment. Realized gains and losses on disposals of these investments are included in the determination of net operating results for the year. Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

Loans are recorded at cost less any allowance for credit loss. Where there is no reasonable assurance of timely collection of the full amount of principal and interest of a loan, a provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

DEPARTMENT OF FINANCE

**NOTE 2 (continued)**

Investments are recorded at cost, except for investments in wholly owned provincial corporations operating as commercial enterprises which are valued on an equity basis. Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

Tangible capital assets acquired by right are not included. Tangible capital assets of the Department are recorded at historical cost and amortized on a straight-line basis over the estimated useful lives of the assets. The threshold for capitalizing new systems development is $100,000 and the threshold for all other tangible capital assets is $5,000 (2004 $15,000).

**LIABILITIES**

Liabilities include all financial claims payable by the Department at fiscal year end.

Debentures included in unmatured debt are recorded at the face amount of the issue less unamortized discount, which includes issue expenses and hedging costs.

Income or expense on interest rate swaps and forward interest rate agreements used to manage interest rate exposure is recorded as an adjustment to debt servicing costs. The exchange gain or loss on the foreign exchange contracts used to manage currency exposure is deferred and amortized over the life of the contract.

**FOREIGN CURRENCY**

Assets and liabilities denominated in foreign currency are translated at the year end rate of exchange.

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts.

Exchange gains and losses that arise on translation of fixed term foreign currency denominated monetary items are deferred and amortized over the life of the contract. Amortization of deferred exchange gains and losses and other exchange differences on unhedged transactions are included in the determination of net operating results for the year.

**NET ASSETS/NET LIABILITIES**

Net assets represents the difference between the carrying value of assets held by the Department and its liabilities.

**MEASUREMENT UNCERTAINTY**

Estimates are used in accruing revenues and expenses in circumstances where the actual accrued revenues and expenses are unknown at the time the financial statements are prepared. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

DEPARTMENT OF FINANCE

**NOTE 2 (continued)**

Measurement uncertainty that is material to these financial statements exists in the accrual of personal and corporate income taxes and provisions for pensions and loans and advances. The nature of the uncertainty in these items arises from several factors such as the effect on accrued taxes of the verification of taxable income, the effect on accrued pensions obligations of actual experience compared to assumptions, and the effect on loans and advances of actual collectibility and changes in economic conditions. Personal income tax, recorded as $4,648,349,000 (2004 $4,612,531,000) in these financial statements, is subject to measurement uncertainty due primarily to the use of economic estimates of personal income growth. Use of this information in the past has resulted in a number that differs from final results by a geometric average of plus or minus $200 million over the last four years.

While best estimates have been used for reporting items subject to measurement uncertainty, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements.

## NOTE 3 REORGANIZATION

*(thousands)*

On November 24, 2004, a restructuring of government ministries was announced resulting in a change in the responsibilities of the Department of Finance. The budget, programs, operations and financial assets and liabilities of the Department of Revenue were transferred to the Department of Finance. Comparative figures for 2004 have been restated as if the Department had always been assigned its current responsibilities.

Net assets (liabilities) at March 31, 2003:

| | |
|---|---|
| Revenue Department | $ 393,382 |
| Finance Department | (4,024,522) |
| Net liabilities, as restated at March 31, 2003 | $ (3,631,140) |

## NOTE 4 VALUATION OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Because of the short term nature of these instruments, the fair values of cash and temporary investments, accrued interest, receivables, bank overdraft, payables and other accrued liabilities are estimated to approximate their book values.

Public fixed-income securities included in portfolio investments are valued at the year end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Fair values of loans and advances are not reported due to there being no organized financial market for the instruments and it is not practicable within constraints of timeliness or cost to estimate the fair values with sufficient reliability.

DEPARTMENT OF FINANCE

**NOTE 4 (continued)**

The fair value of unmatured debt is an approximation of its fair value to the holder.

At the year end, the fair values of assets and liabilities denominated in a foreign currency are translated at the year end exchange rate.

## NOTE 5 RISK MANAGEMENT

### A) LIABILITY MANAGEMENT

The objective of the Department's liability management program is to achieve the lowest cost on debt within an acceptable degree of variability of debt servicing costs. In order to achieve this objective, the Department manages four risks - interest rate risk, currency exchange risk, credit risk, and refinancing risk. The Department manages these four risks within approved policy guidelines. The management of these risks and the policy guidelines apply to the Department's unmatured debt, excluding debt raised to fund requirements of provincial corporations and regulated funds. Debt of provincial corporations and regulated funds is managed separately in relation to their assets.

The Department has decided in light of the current debt reduction environment, that the most effective liability risk management strategy would be to allow existing debt instruments to mature in accordance with their terms.

### B) ASSET MANAGEMENT

Portfolio investments are used to repay debt as it matures, to provide funding for the capital plan, and to help protect operating and capital spending from short-term declines in revenue and the costs of emergencies, disasters and natural gas rebates.

## NOTE 6 CONTRACTUAL OBLIGATIONS

*(thousands)*

### A) CREDIT UNION ACT

The Credit Union Deposit Guarantee Corporation, operating under the authority of the *Credit Union Act*, guarantees the repayment of all deposits with Alberta credit unions, including accrued interest. The *Credit Union Act* provides that the Province, through the Department, will ensure that this obligation of the Corporation is carried out. As at December 31, 2004, credit unions in Alberta held deposits totaling $8,963,176 (2003 $8,240,449). Substantial assets are available to safeguard the Department from risk of loss arising from its potential obligation under the Act.

DEPARTMENT OF FINANCE

**NOTE 6 (continued)**

**B) OTHER COMMITMENTS**
*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Service contracts | $ 4,539 | $ 4,709 |
| Long-term leases | 204 | - |
| | $ 4,743 | $ 4,709 |

The aggregate amounts payable for the unexpired terms of these contractual obligations are as follows:

| | Service Contracts | Leases | Total Restated (Note 3) |
|---|---|---|---|
| 2006 | $ 3,405 | $ 51 | $ 3,456 |
| 2007 | 1,134 | 51 | 1,185 |
| 2008 | - | 51 | 51 |
| 2009 | - | 51 | 51 |
| | $ 4,539 | $ 204 | $ 4,743 |

## NOTE 7 CONTINGENT LIABILITIES

Set out below are details of contingencies resulting from guarantees, indemnities and litigation, other than those reported as liabilities and shown in Schedule 17.

Any losses arising from the settlement of contingencies are treated as current year expenses.

**A) INDEMNITIES AND DEBENTURE, DEPOSIT AND LOAN GUARANTEES**

Guaranteed liabilities at March 31, 2005 of government entities amounting to $18,588,537 (2004 $17,610,400), and other guarantees amounting to $14,791 (2004 $27,342) are analyzed in Schedules 18 and 19 respectively. These schedules are included with the financial statements because payments under debenture and loan guarantees are a statutory charge on the Department.

Payments under the guarantee of Alberta Treasury Branches deposits would also be made by the Department, under authority of a supply vote.

DEPARTMENT OF FINANCE

**NOTE 7 (continued)**

**B) LEGAL ACTIONS (2004 restated see Note 3)**

At March 31, 2005, the Department is jointly or separately named as a defendant in twenty legal claims (2004 eighteen legal claims). Of the twenty claims, nineteen have specified amounts totalling approximately $3,813,056 including one jointly named claim for $3,750,000 and one claim for no specified amount. In 2004 sixteen claims had specified amounts totalling approximately $74,102 and two had no specified amount. Seven claims amounting to $1,886 (2004 eight amounting to $5,822) are covered by the Alberta Risk Management Fund. The resulting loss, if any, from these claims cannot be determined.

In addition, at March 31, 2005, some taxes assessed were under objection and some were being appealed. The resulting loss, if any, cannot be reasonably estimated.

## NOTE 8 TRUST FUNDS UNDER ADMINISTRATION

*(thousands)*

The Department administers trust funds that are regulated funds consisting of public money over which the Legislature has no power of appropriation. Because the Province has no equity in the funds and administers them for the purpose of various trusts, they are not included in the Department's financial statements.

As at March 31, 2005, trust funds under administration were as follows:

| | **2005** | **2004 Restated (Note 3)** |
|---|---|---|
| Local Authorities Pension Plan Fund | $ 11,121,963 | $ 10,068,470 |
| Public Service Pension Plan Fund | 4,550,299 | 4,235,063 |
| The Workers' Compensation Board Accident Fund | 2,606,800 | 2,328,797 |
| Universities Academic Pension Plan Fund | 1,928,313 | 1,808,091 |
| Management Employees Pension Plan Fund | 1,755,326 | 1,633,697 |
| Special Forces Pension Plan Fund | 1,175,418 | 1,102,139 |
| Regional Health Authorities and various health institutions construction accounts | 914,877 | 395,975 |
| Power Pool of Alberta Balancing Pool | 32,697 | 115,892 |
| Other | 136,173 | 88,565 |
| | $ 24,221,866 | $ 21,776,689 |

DEPARTMENT OF FINANCE

## NOTE 9 DEFINED BENEFIT PLANS

*(thousands)*

The Department sponsors and participates in the multi-employer pension plans, Management Employees Pension Plan and Public Service Pension Plan (see Schedule 16 (c)). The Department also participates in the multi-employer Supplementary Retirement Plan for Public Service Managers. The expense of these plans is equivalent to the annual contributions of $3,266 for the year ended March 31, 2005 (2004 $3,003).

At December 31, 2004, the Management Employees Pension Plan reported a deficiency of $268,101 (2003 $290,014) and the Public Service Pension Plan reported a deficiency of $450,068 (2003 $584,213). At December 31, 2004, the Supplementary Retirement Plan for Public Service Managers had a surplus of $9,404 (2003 $9,312)

The Department also participates in two multi-employer Long Term Disability Income Continuance Plans. At March 31, 2005, the Bargaining Unit Plan reported an actuarial deficiency of $11,817 (2004 $9,766) and the Management, Opted Out and Excluded Plan an actuarial surplus of $3,208 (2004 $1,298). The expense for these two plans is limited to the employer's annual contributions for the year.

## NOTE 10 COMPARATIVE FIGURES

Certain figures have been restated to conform to 2005 presentation.

## NOTE 11 APPROVAL OF FINANCIAL STATEMENTS

The Senior Financial Officer and the Deputy Minister approved these financial statements.

DEPARTMENT OF FINANCE

## SCHEDULES TO THE FINANCIAL STATEMENTS

**REVENUES** **Schedule 1**

Year Ended March 31, 2005 *(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Actual Restated (Note 3) |
|---|---|---|---|
| Internal government transfers | | | |
| Alberta Heritage Savings Trust Fund | $ 644,241 | $ 1,091,903 | $ 1,133,484 |
| Lottery Fund | 84,365 | 154,748 | 137,755 |
| | 728,606 | 1,246,651 | 1,271,239 |
| Income taxes | | | |
| Personal income tax | 5,084,671 | 4,648,349 | 4,612,531 |
| Corporate income tax | 1,957,285 | 2,364,315 | 1,696,427 |
| | 7,041,956 | 7,012,664 | 6,308,958 |
| Other taxes | | | |
| Tobacco tax | 660,000 | 697,656 | 670,502 |
| Fuel tax | 607,000 | 640,918 | 619,585 |
| Insurance taxes | 164,731 | 209,716 | 203,492 |
| Hotel room tax | 60,000 | 61,021 | 53,325 |
| Financial institutions capital tax | - | 149 | 515 |
| Special broker tax | 750 | 2,867 | 2,668 |
| | 1,492,481 | 1,612,327 | 1,550,087 |
| Transfers from Government of Canada | | | |
| Unconditional subsidy | 4,055 | 4,178 | 4,100 |
| Investment income | | | |
| Farm credit stability program | 2,100 | 2,245 | 3,620 |
| Other | 189,044 | 261,505 | 220,386 |
| | 191,144 | 263,750 | 224,006 |
| Fees, permits and licences | | | |
| Deposit guarantee fee | 16,585 | 15,785 | 11,836 |
| Insurance companies, agents and brokers | 250 | 246 | 228 |
| Other | 1,209 | 1,283 | 1,314 |
| | 18,044 | 17,314 | 13,378 |
| Transfers from government enterprises | | | |
| The Alberta Government Telephones Commission | - | - | 21,495 |
| Other | | | |
| Cost recovery from dedicated revenue initiatives (Schedule 2) | 17,738 | 15,330 | 12,914 |
| Sale of assets | - | 10 | 8 |
| Refunds of expenditure | 50 | 465 | 183 |
| Miscellaneous | 2,334 | 4,578 | 2,190 |
| | 20,122 | 20,383 | 15,295 |
| | $ 9,496,408 | $ 10,177,267 | $ 9,408,558 |

DEPARTMENT OF FINANCE

## DEDICATED REVENUE INITIATIVES

**Schedule 2**

*(thousands)*

| | 2005 Authorized Dedicated Revenues | 2005 Actual Dedicated Revenues | (Shortfall) (a)/ Excess |
|---|---|---|---|
| Revenue collection and rebates | $ 225 | $ 186 | $ (39) |
| Investment | 16,311 | 13,918 | (2,393) |
| Risk management and insurance | 1,202 | 1,226 | 24 |
| | $ 17,738 | $ 15,330 | $ (2,408) |

Following is a brief description of each dedicated revenue initiative:

- Revenue collection and rebates: Recovers the costs associated with administration of the payment in lieu of tax program, related to municipally-owned utilities, from the Power Pool of Alberta Balancing Pool.
- Investment: Manages the investments of various public sector investment funds. Fees are based on cost recovery.
- Risk management and insurance: Recovers costs of risk management and insurance services from the Alberta Risk Management Fund.

The revenue of each initiative is reported in the statement of operations.

a) The shortfall is deducted from the current year's authorized budget, as disclosed in Schedules 4 and 5 to the financial statements.

DEPARTMENT OF FINANCE

## EXPENSES - DIRECTLY INCURRED DETAILED BY OBJECT — Schedule 3

*(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Actual Restated (Note 3) |
|---|---|---|---|
| Voted | | | |
| Salaries, wages and employee benefits | $ 42,718 | $ 40,651 | $ 36,551 |
| Supplies and services | 22,688 | 21,319 | 18,656 |
| Grants | 53,042 | 53,033 | 61,637 |
| Financial transactions and other | 1,325 | 1,113 | 1,128 |
| Amortization of tangible capital assets | 2,931 | 2,695 | 2,395 |
| Total voted expenses before recoveries | 122,704 | 118,811 | 120,367 |
| Less recovery from support service arrangements with related parties (a) | 64 | 85 | 73 |
| | $ 122,640 | $ 118,726 | $ 120,294 |
| Statutory | | | |
| Interest payments on corporate tax refunds | $ 20,000 | $ 27,358 | $ 15,641 |
| Farm credit stability program | 300 | 292 | 501 |
| Pension liability funding | 73,700 | 71,045 | 69,242 |
| Debt servicing costs | 302,000 | 243,072 | 204,352 |
| Valuation adjustments (Schedule 6) | (12,500) | 5,944 | 5,520 |
| | $ 383,500 | $ 347,711 | $ 295,256 |

a) The Department provides financial, administrative and human resource services to various departments and Offices of the Legislative Assembly. Costs incurred by the Department are recovered from the recipients of the services.

DEPARTMENT OF FINANCE

## BUDGET

**Schedule 4**

*(thousands)*

| | 2004-05 Estimates | Adjustments (a) | 2004-05 Budget | Authorized Supplementary Estimates (b) | 2004-05 Authorized Budget |
|---|---|---|---|---|---|
| Revenues | | | | | |
| Internal government transfers | $ 728,606 | $ - | $ 728,606 | $ - | $ 728,606 |
| Income taxes | 7,041,956 | - | 7,041,956 | - | 7,041,956 |
| Other taxes | 1,492,481 | - | 1,492,481 | - | 1,492,481 |
| Transfers from Government of Canada | 4,055 | - | 4,055 | - | 4,055 |
| Investment income | 191,144 | - | 191,144 | - | 191,144 |
| Fees, permits and licences | 18,044 | - | 18,044 | - | 18,044 |
| Other | 20,122 | - | 20,122 | - | 20,122 |
| | 9,496,408 | - | 9,496,408 | - | 9,496,408 |
| Expenses - Directly Incurred | | | | | |
| Voted | | | | | |
| Ministry support services | 9,246 | - | 9,246 | - | 9,246 |
| Fiscal planning and accountability | 9,286 | - | 9,286 | - | 9,286 |
| Pensions, insurance and financial institutions | 3,919 | - | 3,919 | 1,400 | 5,319 |
| Treasury management | 2,732 | - | 2,732 | - | 2,732 |
| Long term revenue and investment policy | 1,797 | - | 1,797 | - | 1,797 |
| Revenue collection and rebates | 23,864 | - | 23,864 | - | 23,864 |
| Investment | 17,574 | - | 17,574 | - | 17,574 |
| Risk management and insurance | 1,202 | - | 1,202 | - | 1,202 |
| Debt servicing costs | 53,020 | - | 53,020 | - | 53,020 |
| Dedictated revenue shortfall (Schedule 2) | - | (2,408) | (2,408) | - | (2,408) |
| | 122,640 | (2,408) | 120,232 | 1,400 | 121,632 |
| Statutory | | | | | |
| Interest payment on corporate tax refunds | 20,000 | - | 20,000 | - | 20,000 |
| Farm credit stability program | 300 | - | 300 | - | 300 |
| Pension liability funding | 73,700 | - | 73,700 | - | 73,700 |
| Debt servicing costs | 302,000 | - | 302,000 | - | 302,000 |
| Valuation adjustments | 500 | (13,000) | (12,500) | - | (12,500) |
| | 396,500 | (13,000) | 383,500 | - | 383,500 |
| | 519,140 | (15,408) | 503,732 | 1,400 | 505,132 |
| Net operating results | $ 8,977,268 | $ 15,408 | $ 8,992,676 | $ (1,400) | $ 8,991,276 |
| Equipment/inventory purchases | $ 2,434 | $ - | $ 2,434 | $ - | $ 2,434 |

a) Adjustments consist of $2,408 for dedicated revenue shortfall and $13,000 for pension provisions excluded from the Estimates.

b) Supplementary Estimates were approved on March 24, 2005.

DEPARTMENT OF FINANCE

## COMPARISON OF EXPENSES AND EQUIPMENT/INVENTORY PURCHASES AND DISBURSEMENTS BY ELEMENT TO AUTHORIZED BUDGET

**Schedule 5**

*(thousands)*

| | 2004-05 Budget | Authorized Supplementary Estimates (a) | 2004-05 Authorized Budget | 2004-05 Actual Expense (b) | Unexpended (Over Expended) |
|---|---|---|---|---|---|
| Voted Expenses and Equipment/ Inventory Purchases | | | | | |
| Program Ministry Support Services | | | | | |
| Minister's Office | $ 592 | - | $ 592 | $ 526 | $ 66 |
| Finance Deputy Minister's Office | 405 | - | 405 | 616 | (211) |
| Revenue Deputy Minister's Office | 353 | - | 353 | 473 | (120) |
| Strategic and Business Services | | | | | |
| - Operating Expense | 7,099 | - | 7,099 | 7,506 | (407) |
| - Equipment/Inventory Purchases | 50 | - | 50 | 89 | (39) |
| Communications | 704 | - | 704 | 496 | 208 |
| Standing Policy Committee on Economic Development and Finance | 93 | - | 93 | 122 | (29) |
| | 9,296 | - | 9,296 | 9,828 | (532) |
| Program - Fiscal Planning and Accountability | | | | | |
| Office of Budget and Management | 9,286 | - | 9,286 | 8,251 | 1,035 |
| Program - Pensions, Insurance and Financial Institutions | | | | | |
| Assistant Deputy Minister's Office | 468 | - | 468 | 533 | (65) |
| Financial Institutions Regulation | 2,647 | 1,400 | 4,047 | 4,619 | (572) |
| Pension Policy | 442 | - | 442 | 496 | (54) |
| Corporate Management Services to Alberta Capital Finance Authority | 362 | - | 362 | 302 | 60 |
| | 3,919 | 1,400 | 5,319 | 5,950 | (631) |
| Program - Treasury Management | | | | | |
| Treasury Management | | | | | |
| - Operating Expense | 2,732 | - | 2,732 | 2,151 | 581 |
| - Equipment/Inventory Purchases | 30 | - | 30 | - | 30 |
| | 2,762 | - | 2,762 | 2,151 | 611 |
| Program - Long Term Revenue and Investment Policy | | | | | |
| Policy and Strategic Planning and Special Projects | 1,797 | - | 1,797 | 846 | 951 |
| Program - Revenue Collection and Rebates | | | | | |
| Tax and Revenue Administration | | | | | |
| - Operating Expense | 23,864 | - | 23,864 | 22,589 | 1,275 |
| - Equipment/Inventory Purchases | 1,204 | - | 1,204 | 1,410 | (206) |
| | 25,068 | - | 25,068 | 23,999 | 1,069 |

DEPARTMENT OF FINANCE

## COMPARISON OF EXPENSES AND EQUIPMENT/INVENTORY PURCHASES AND DISBURSEMENTS BY ELEMENT TO AUTHORIZED BUDGET

**Schedule 5 *(continued)***

*(thousands)*

| | 2004-05 Budget | Authorized Supplementary Estimates (a) | 2004-05 Authorized Budget | 2004-05 Actual Expense (b) | Unexpended (Over Expended) |
|---|---|---|---|---|---|
| Program - Investment | | | | | |
| Investment Management | 10,637 | - | 10,637 | 8,401 | 2,236 |
| Internal Audit | 500 | - | 500 | 319 | 181 |
| Securities Administration and Systems | | | | | |
| - Operating Expense | 6,437 | - | 6,437 | 6,257 | 180 |
| - Equipment/Inventory Purchases | 1,150 | - | 1,150 | 945 | 205 |
| | 18,724 | - | 18,724 | 15,922 | 2,802 |
| Program - Risk Management and Insurance | | | | | |
| Risk Management and Insurance | 1,202 | - | 1,202 | 1,212 | (10) |
| Debt Servicing | | | | | |
| Grants for School Construction Debenture Interest Payments | 53,020 | - | 53,020 | 53,011 | 9 |
| | 125,074 | 1,400 | 126,474 | 121,170 | 5,304 |
| Dedicated Revenue Shortfall (Schedule 2) | (2,408) | - | (2,408) | - | (2,408) |
| | $ 122,666 | 1,400 | $ 124,066 | $ 121,170 | $ 2,896 |
| Summary | | | | | |
| Program Operating Expense | $ 120,232 | 1,400 | $ 121,632 | $ 118,726 | $ 2,906 |
| Equipment/Inventory Purchases | 2,434 | - | 2,434 | 2,444 | (10) |
| | $ 122,666 | 1,400 | $ 124,066 | $ 121,170 | $ 2,896 |
| Statutory Expenses | | | | | |
| Interest payment on corporate tax refunds | $ 20,000 | - | $ 20,000 | $ 27,358 | $ (7,358) |
| Farm credit stability program | 300 | - | 300 | 292 | 8 |
| Pension liability funding | 73,700 | - | 73,700 | 71,045 | 2,655 |
| Debt servicing costs | 302,000 | - | 302,000 | 243,072 | 58,928 |
| Valuation adjustments | (12,500) | - | (12,500) | 5,944 | (18,444) |
| | $ 383,500 | - | $ 383,500 | $ 347,711 | $ 35,789 |
| Voted Non-Budgetary Disbursements | | | | | |
| Grants for school construction debenture principal repayment | $ 75,059 | - | $ 75,059 | $ 74,969 | $ 90 |

a) Supplementary Estimates were approved on March 24, 2005.

b) Includes achievement bonus of $2,323.

DEPARTMENT OF FINANCE

## VALUATION ADJUSTMENTS — Schedule 6

*(thousands)*

| | Budget | 2005 Actual | 2004 Actual Restated (Note 3) |
|---|---|---|---|
| Pension provisions | $ (13,000) | $ 6,541 | $ 2,445 |
| Provision for employee benefits other than pensions | - | (20) | 471 |
| Provision for doubtful accounts and loans | 500 | (581) | 3,570 |
| Provision for guarantees and indemnities | - | 4 | (966) |
| | $ (12,500) | $ 5,944 | $ 5,520 |

## SALARY AND BENEFITS DISCLOSURE — Schedule 7

| | 2005 Base Salary (1) | Other Cash Benefits (2) | Other Non-Cash Benefits (3) | Total | 2004 Total |
|---|---|---|---|---|---|
| Senior Officials | | | | | |
| Deputy Minister of Finance(4)(5)(6) | $ 175,575 | $ 103,621 | $ 34,354 | $ 313,550 | $ 245,767 |
| Deputy Minister of Revenue(4)(7) | 157,392 | 60,123 | 35,276 | 252,791 | 236,234 |
| Controller (4) | 128,052 | 18,823 | 27,711 | 174,586 | 172,382 |
| Executives | | | | | |
| Assistant Deputy Minister - Pensions, Insurance and Financial Institutions | 132,204 | 39,645 | 25,875 | 197,724 | 175,942 |
| Assistant Deputy Minister - Revenue(7) | 122,112 | 33,857 | 25,541 | 181,510 | 162,904 |
| Chief Investment Officer(7)(8) | 241,500 | 157,965 | 44,665 | 444,130 | 349,652 |
| Executive Director, Treasury Management | 132,204 | 19,434 | 28,494 | 180,132 | 167,721 |
| Chief Administrative Officer(7) | 132,216 | 30,256 | 28,425 | 190,897 | 170,085 |

1) Base salary includes regular base pay.
2) Other cash benefits include bonuses, vacation payouts and lump sum payments.
3) Other non-cash benefits include the government's share of all employee benefits and contributions or payments made on behalf of employees including pensions, health care, dental coverage, group life insurance, short and long term disability plans, professional memberships and tuition fees.
4) Automobile provided, no dollar amount included in benefits and allowances figures.
5) Position occupied by two individuals during the year.
6) Other cash benefits include $64,372 for vacation payout to the previous incumbent.
7) As a result of the amalgamation of the Ministries of Finance and Revenue on November 24, 2004, these positions have been transferred from the former Department of Revenue to the Department of Finance.
8) Base salary includes regular base pay and a market modifier.

DEPARTMENT OF FINANCE

## CASH AND TEMPORARY INVESTMENTS — Schedule 8

*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Fixed-income securities (a) | | |
| Government of Canada, direct and guaranteed | $ 144,666 | $ 431,770 |
| Provincial, direct and guaranteed | 129,585 | 39,850 |
| Corporate | 1,439,061 | 659,932 |
| | 1,713,312 | 1,131,552 |
| Deposit in Consolidated Cash Investment Trust Fund | 948,606 | 863,168 |
| Cash in bank and in transit | 784,238 | 148,270 |
| | $ 3,446,156 | $ 2,142,990 |

a) Fixed-income securities have an average effective yield of 2.7% (2004 2.2%) per annum. All of the securities had terms to maturity of less than one year (2004 less than one year).

## ACCOUNTS AND ACCRUED INTEREST RECEIVABLE — Schedule 9

*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Personal income tax | $ 265,486 | $ 346,065 |
| Corporate income tax (a) | 37,275 | 291,935 |
| Alberta Heritage Savings Trust Fund | 62,388 | 152,484 |
| Alberta Treasury Branches | 81,503 | 73,237 |
| Fuel tax | 62,529 | 56,911 |
| Lottery Fund | 68,422 | 52,756 |
| Present value of future contributions from credit union system | 38,695 | 47,695 |
| Accrued interest receivable | 77,007 | 46,616 |
| Insurance corporations tax | 50,083 | 39,573 |
| Tobacco tax | 6,024 | 16,992 |
| Swap accruals | 16,403 | 15,106 |
| Hotel room tax | 5,437 | 4,851 |
| Other | 5,757 | 6,303 |
| Financial institutions capital tax | 1,965 | 1,855 |
| The Alberta Government Telephones Commission | - | 185 |
| | 778,974 | 1,152,564 |
| Less allowance for doubtful accounts | 3,466 | 4,018 |
| | $ 775,508 | $ 1,148,546 |

a) During the year, the methodology used to estimate corporate income tax receivable was changed to include an estimated accrual for corporate income tax refunds payable based on a five year moving average.

DEPARTMENT OF FINANCE

## PORTFOLIO INVESTMENTS — Schedule 10

*(thousands)*

| | 2005 Book Value | 2005 Fair Value | 2004 Book Value | 2004 Fair Value |
|---|---|---|---|---|
| Fixed-income securities (a) | | | | |
| Government of Canada, direct and guaranteed | $ 535,086 | $ 535,649 | $ 963,239 | $ 967,217 |
| Provincial, direct and guaranteed | 2,218,264 | 2,227,197 | 1,043,995 | 1,051,195 |
| Municipal | 71,639 | 71,617 | 14,250 | 14,459 |
| Corporate | 3,360,124 | 3,356,610 | 2,060,381 | 2,071,659 |
| | $ 6,185,113 | $ 6,191,073 | $ 4,081,865 | $ 4,104,530 |

a) The Department's fixed-income securities are held to repay debt as it matures, to provide funding for the capital plan, and to help protect operating and capital spending from short-term declines in revenue and the costs of emergencies, disasters and natural gas rebates. The securities held have an average effective market yield of 3.4% (2004 2.3%) per annum and 65.8% (2004 77.3%) of the securities have terms to maturity of less than two years.

## LOANS AND ADVANCES TO GOVERNMENT ENTITIES — Schedule 11

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Agriculture Financial Services Corporation | $ 899,750 | $ 911,867 |
| Alberta Social Housing Corporation | 312,944 | 330,369 |
| Public Trustee | 224 | 224 |
| | $ 1,212,918 | $ 1,242,460 |

DEPARTMENT OF FINANCE

## OTHER LOANS, ADVANCES AND INVESTMENTS

Schedule 12

*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Loans and advances | | |
| Farm Credit Stability Act | $ 14,445 | $ 25,878 |
| Board of Governors of the University of Alberta | 1,292 | 1,663 |
| Pratt & Whitney Canada Ltd. | 851 | 1,407 |
| University of Lethbridge Students' Union | 422 | 611 |
| Implemented guarantees and indemnities | 144 | 201 |
| Judgement debts | 47 | 51 |
| Accountable advances | 21 | 394 |
| | 17,222 | 30,205 |
| Less allowance for doubtful loans and advances | 191 | 253 |
| | 17,031 | 29,952 |
| Investments | | |
| N.A. Properties (1994) Ltd. | 1,623 | 1,439 |
| Alberta Capital Finance Authority | 45 | 45 |
| | 1,668 | 1,484 |
| | $ 18,699 | $ 31,436 |

## TANGIBLE CAPITAL ASSETS

Schedule 13

*(thousands)*

| | Estimated Useful Life | Cost | Accumulated Amortization | 2005 Net Book Value | 2004 Net Book Value Restated (Note 3) |
|---|---|---|---|---|---|
| Computer hardware and software | 5 years | $ 21,246 | $ 12,393 | $ 8,853 | $ 9,139 |

## ACCOUNTS AND ACCRUED INTEREST PAYABLE

Schedule 14

*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Corporate income tax receipts in abeyance | $ 364,942 | $ 345,925 |
| Accrued interest on unmatured debt | 61,889 | 108,280 |
| Other | 71,174 | 29,196 |
| | $ 498,005 | $ 483,401 |

DEPARTMENT OF FINANCE

## UNMATURED DEBT

**Schedule 15**

*(thousands)*

| | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|
| | Effective Rate (a)(b)(c) % | Modified Duration (d) years | Book Value (a) | Fair Value (a) | Book Value (a) | Fair Value (a) |
| Canadian dollar debt and fully hedged foreign currency debt | | | | | | |
| Floating rate and short-term fixed rate (e) | 5.25 | 0.42 | $ 1,307,481 | $ 1,313,269 | $ 1,529,533 | $ 1,555,966 |
| Fixed rate long-term (f) | 6.92 | 4.22 | 2,284,613 | 2,601,025 | 2,932,683 | 3,429,457 |
| | 6.31 | 2.94 | 3,592,094 | 3,914,294 | 4,462,216 | 4,985,423 |
| Unhedged U.S. dollar debt (g) | | | | | | |
| Floating rate and short-term fixed rate (e) | 3.75 | 0.32 | 130,156 | 122,999 | 680,239 | 694,077 |
| Fixed rate long-term | - | - | - | - | 47,961 | 52,941 |
| | 3.75 | 0.32 | 130,156 | 122,999 | 728,200 | 747,018 |
| | 6.22 | 2.86 | $ 3,722,250 | $ 4,037,293 | $ 5,190,416 | $ 5,732,441 |

a) Book value represents the amount the Department owes. Fair value is an approximation of market value to the holder. The book value, fair value and weighted average effective rate include the effect of interest rate and currency rate swaps. For non-marketable issues, the effective rate and fair value are determined by reference to yield curves for comparable quoted issues.

b) Weighted average effective rates on unhedged U.S. dollar debt are based upon debt stated in U.S. dollars.

c) Weighted average effective rate on total unmatured debt is on debt inclusive of deferred exchange gains on unhedged U.S. dollar debt (see note (g)).

d) Modified duration is the weighted average term to maturity of the security's cash flows (i.e. interest and principal) and is a measure of price volatility; the greater the modified duration of a bond, the greater its percentage price volatility.

e) Floating rate debt includes short-term debt, term debt with less than one year remaining to maturity, and term debt with interest rate reset within a year.

f) Canadian dollar fixed rate debt includes $678,696 (2004 $678,696) held by the Canada Pension Plan Investment Fund.

g) U.S. dollar debt includes the Department's effective exposure to U.S. dollars through cross-currency swaps totaling $107,600 U.S. at March 31, 2005. Unhedged U.S. dollar debt is translated into Canadian dollars at the March 31 noon exchange rate of $1.21 per U.S. dollar (2004 $1.31 per U.S. dollar). Deferred exchange gains on unhedged U.S. dollar debt amounted to $5,879 at March 31, 2005 (2004 $4,653). Amortization of deferred exchange gains amounted to $1,420 for the year ended March 31, 2005 (2004 $146,260). In Budget 2004, a change in the exchange rate of one U.S. cent to the Canadian dollar was estimated to have a $6 million effect on debt servicing costs.

DEPARTMENT OF FINANCE

**Schedule 15** (continued)

Debt principal repayment requirements at par in each of the next five years, including short-term debt maturing in 2005-06, and thereafter are as follows:

*(thousands)*

| | **Total in Canadian Dollars** | **Unhedged in U.S. Dollars** |
|---|---|---|
| 2005-06 | $1,355,119 | $107,600 |
| 2006-07 | 149,379 | - |
| 2007-08 | 273,428 | - |
| 2008-09 | 730,679 | - |
| 2009-10 | 78,342 | - |
| Thereafter | 1,144,171 | - |
| | $3,731,118 | $107,600 |

None of the debt has call provisions (2004 none).

**Derivative Financial Instruments**

The Department uses interest rate swaps and cross-currency interest rate swaps and contracts to manage the interest rate risk and currency exposure associated with unmatured debt. In addition, forward interest rate agreements are used to manage interest rate exposure in the short term. Associated with these instruments are credit risks that could expose the Department to potential losses. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Credit exposure to counterparties is a fraction of the notional principal amount, as shown in the table below. The Department minimizes its credit risk associated with these contracts by dealing with only the most credit worthy counterparties.

Interest rate swaps involve the exchange of a series of interest payments, either at a fixed or floating rate, based upon a contractual or notional principal amount. An interest rate swap agreement based upon a notional amount involves no exchange of underlying principal. The notional amount serves as the basis for determining the exchange of interest payments. At March 31, 2005, interest rate swap agreements were being used primarily to convert fixed interest rate payments to floating rates.

Cross-currency interest rate swaps involve both the swapping of interest rates and currencies.

DEPARTMENT OF FINANCE

**Schedule 15** (continued)

The following table summarizes the Department's derivative portfolio and related credit exposure. Notional amount represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows. The notional amounts are not recorded in the financial statements. Replacement cost represents the cost of replacing, at current market rates, all contracts that have a positive fair value. The fair value of interest rate swaps and cross-currency interest rate swaps are based on discounted cash flows using current market yields and exchange rates.

*(thousands)*

| | 2005 Notional Amount | 2005 Replacement Cost | 2004 Notional Amount | 2004 Replacement Cost |
|---|---|---|---|---|
| Interest rate swaps | $ 825,000 | $ 25,825 | $ 1,131,000 | $ 50,394 |
| Cross-currency interest rate swaps | 173,905 | 21,365 | 498,173 | 29,727 |
| | $ 998,905 | $ 47,190 | $ 1,629,173 | $ 80,121 |

DEPARTMENT OF FINANCE

## PENSION OBLIGATIONS Schedule 16

*(thousands)*

The Department's pension obligations are described below.

| | 2005 | 2004 |
|---|---|---|
| Obligations to pension plans for current and former employees and Members of the Legislative Assembly | | |
| Public Service Management (Closed Membership) Pension Plan (a) | $ 656,274 | $ 675,856 |
| Members of the Legislative Assembly Pension Plan (b) | 46,770 | 49,625 |
| Management Employees Pension Plan (c) | 12,349 | - |
| Public Service Pension Plan (c) | 8,181 | - |
| | 723,574 | 725,481 |
| Obligations to pension plans for employees of organizations outside the government reporting entity | | |
| Universities Academic Pension Plan (d) | 184,760 | 171,501 |
| Special Forces Pension Plan (d) | 62,899 | 67,710 |
| | 247,659 | 239,211 |
| | $ 971,233 | $ 964,692 |

a) The Public Service Management (Closed Membership) Pension Plan provides benefits to former members of the Public Service Management Pension Plan who were retired, were entitled to receive a deferred pension or had attained 35 years of service before August 1, 1992. The costs of all benefits under the plan are paid by the Department.

b) The Department has a liability for payment of pension benefits under a defined benefit pension plan for Members of the Legislative Assembly. Active participation in this plan was terminated as of June 1993, and no benefits can be earned for service after this date.

c) The Department is the sponsor of two multi-employer defined benefit pension plans on behalf of the Government of Alberta. The two plans are the Management Employees Pension Plan (MEPP) and the Public Service Pension Plan (PSPP). For each Plan, current service costs and the Plan's deficiency are being financed by employer and employee contributions at rates which together with investment earnings are expected to provide for all benefits payable under the Plan. Contributions from employer and employees are in the ratio of 58.0% and 42.0% respectively for MEPP and 50.0% each for PSPP. The Department records the Government's share of the employer's estimated accrued benefit liability for each of these plans. An accrued benefit asset is not recorded.

d) Under the *Public Sector Pension Plans Act*, the Department has obligations for payment of additional contributions under defined benefit pension plans for certain employees of post-secondary educational institutions and municipalities. The plans are the Universities Academic and the Special Forces plans.

For Universities Academic, the unfunded liability for service credited prior to January 1, 1992 is being financed by additional contributions of 1.25% of pensionable salaries by the Department, and contributions by employers and employees to fund the remaining amount, as determined by the plan valuation, over the period ending on or before December 31, 2043. Employers and employees fund current service costs.

For Special Forces, the unfunded liability for service credited prior to January 1, 1992 is being financed by additional contributions in the ratio of 45.45% by the Department and 27.27% each by employers and employees, over the period ending on or before December 31, 2036. Current service costs are funded by employers and employees. The Act provides that payment of all benefits arising from pensionable service prior to 1994, excluding post-1991 cost of living adjustment benefits, is guaranteed by the Province.

DEPARTMENT OF FINANCE

**Schedule 16 (continued)**

Pension obligations are based upon actuarial valuations performed at least triennially using the projected benefit method prorated on services. The assumptions used in the valuations were adopted after consultation between the pension plan boards, the government and the actuaries, depending on the plan, and represent best estimates of future events. Each plan's future experience will inevitably vary, perhaps significantly, from the assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations. Gains and losses are amortized over the expected average remaining service lives of the employee group.

Information about the economic assumptions used in the most recent actuarial valuations is provided below for each plan. Demographic assumptions used in the valuations reflect the experience of the plans.

| Plan | Latest Valuation | Real Rate of of Return % | Inflation Rate % | Investment Rate of Return % |
|---|---|---|---|---|
| Public Service Management (Closed Membership) Pension Plan | December 31, 2002 | 3.00 | 3.00 | 6.00 |
| Members of the Legislative Assembly Pension Plan | March 31, 2003 | 3.00 | 3.00 | 6.00 |
| Management Employees Pension Plan | December 31, 2003 | 4.00 | 2.75 | 6.75 |
| Public Service Pension Plan | December 31, 2002 | 3.75 | 3.25 | 7.00 |
| Universities Academic Pension Plan | December 31, 2004 | 4.00 | 2.75 | 6.75 |
| Special Forces Pension Plan | December 31, 2001 | 3.75 | 3.25 | 7.00 |

These actuarial valuations indicated a deficiency of net assets over actuarial present value of accrued benefits. Including deferred losses of $354,932 (2004 $369,207), unfunded liabilities were extrapolated to March 31, 2005.

A separate pension plan fund is maintained for each pension plan except for the members of the Legislative Assembly plan. Pension plan fund assets are invested in both marketable investments of organizations external to the government and in Province of Alberta bonds and promissory notes.

DEPARTMENT OF FINANCE

## OTHER ACCRUED LIABILITIES — Schedule 17

*(thousands)*

| | 2005 | 2004 Restated (Note 3) |
|---|---|---|
| Future funding to school boards to enable them to repay debentures issued to the Alberta Capital Finance Authority | $ 450,657 | $ 525,626 |
| Guarantees and indemnities (Schedule 19) | 2,550 | 2,550 |
| Vacation entitlements | 4,385 | 4,501 |
| Other | 332 | 344 |
| | $ 457,924 | $ 533,021 |

## GUARANTEED DEBT OF GOVERNMENT ENTITIES — Schedule18

*(thousands)*

| | Held by: Department of Finance | Alberta Heritage Savings Trust Fund | Others | Total 2005 | Total 2004 |
|---|---|---|---|---|---|
| Debentures | | | | | |
| Alberta Capital Finance Authority | $ - | $ - | $ 4,267,567 | $ 4,267,567 | $ 4,069,558 |
| Alberta Social Housing Corporation | 312,944 | 88,340 | 79,654 | 480,938 | 505,722 |
| | 312,944 | 88,340 | 4,347,221 | 4,748,505 | 4,575,280 |
| Deposits | | | | | |
| Alberta Treasury Branches | 2,579 | - | 13,837,453 | 13,840,032 | 13,035,120 |
| | $ 315,523 | $ 88,340 | $ 18,184,674 | $ 18,588,537 | $ 17,610,400 |

Guarantees include principal borrowings only and exclude guaranteed interest, the amount of which is not determinable.

The net asset position from the most recent financial statements of government entities with guaranteed liabilities are reported below.

*(thousands)*

| Entity | Date | Position | 2005 | 2004 |
|---|---|---|---|---|
| Alberta Capital Finance Authority | December 31, 2004 | Shareholders' Equity | $ 12,728 | $ 22,470 |
| Alberta Social Housing Corporation | March 31, 2005 | Surplus | $ 371,674 | $ 322,309 |
| Alberta Treasury Branches | March 31, 2005 | Equity | $ 1,150,274 | $ 962,961 |

DEPARTMENT OF FINANCE

**OTHER GUARANTEES (a)** **Schedule 19**

(thousands)

| | 2005 | 2004 | Expiry Date |
|---|---|---|---|
| Farm Credit Stability Act (b) | $ 15,175 | $ 27,081 | 2011 |
| Centre for Engineering Research Inc. | 792 | 1,149 | 2005 |
| University of Calgary | 1,004 | 1,071 | 2016 |
| Rural utilities loans | 370 | 591 | 2015 |
| | 17,341 | 29,892 | |
| Less estimated liability (Schedule 17) | 2,550 | 2,550 | |
| | $ 14,791 | $ 27,342 | |

a) Authorized loan guarantee limits decline as guaranteed loans are repaid.

The lender takes appropriate security prior to issuing a loan to the borrower, which is guaranteed by the Province. The security taken depends on the nature of the loan. Interest rates are negotiated with the lender by the borrower and typically range from prime to prime plus two per cent.

No new program guarantees are being issued under the following Acts: *Farm Credit Stability Act, Rural Utilities Act*.

b) The expiry date shown is the latest expiry date for guaranteed loans under the program.

DEPARTMENT OF FINANCE

## RELATED PARTY TRANSACTIONS Schedule 20

Related parties are those entities consolidated or accounted for on the modified equity basis in the Province of Alberta's financial statements. Related parties also include management in the Department.

As explained in Note 2(A), the Department is responsible for managing all departments' cash transactions. As a result, the Department engages in transactions with its own funds and agencies and with all other departments and their funds and agencies in the normal course of operations.

The Deputy Minister of Finance is a director of the Alberta Pensions Administration Corporation and the Alberta Capital Finance Authority. Alberta Pensions Administration Corporation is wholly owned and Alberta Capital Finance Authority is 70% owned by the Government of Alberta, through the Department. The Deputy Minister of Finance did not receive any benefit during the year, in cash or in kind, as a result of these directorships.

The investment in Alberta Capital Finance Authority is recorded at cost (see Schedule 12) because the Corporation has the power to pay its retained earnings, which amounted to $12,664,000 at December 31, 2004 (2003 $22,406,000), to municipal and other shareholders, which have borrowed money from the Corporation. During the 2004-05 fiscal year, the Department paid $127,980,000 (2004 $144,002,000) to the Corporation by way of grants to school boards to satisfy their interest and principal repayment obligations in respect of school board debentures. These amounts are not included in the table below as school boards are not related parties. The investment in Alberta Pensions Administration Corporation is not significant, either on a cost or on an equity basis.

The Department and its employees paid or collected certain taxes and fees set by regulation for permits, licences and other charges. These amounts were incurred in the normal course of business, reflect charges applicable to all users, and have been excluded from this Schedule.

DEPARTMENT OF FINANCE

**Schedule 20 (continued)**
*(thousands)*

The Department had the following transactions with related parties recorded on the Statement of Operations and the Statement of Financial Position at the amount of consideration agreed upon between the related parties.

| | Entities in the Ministry | | Other Entities | |
|---|---|---|---|---|
| | **2005** | **2004 Restated (Note 3)** | **2005** | **2004 Restated (Note 3)** |
| Revenues | | | | |
| Transfers | $ 1,091,903 | $ 1,154,979 | $ 154,748 | $ 137,755 |
| Interest | 3,937 | 5,924 | 65,435 | 68,913 |
| Charges for services | 19,961 | 15,626 | 45 | 798 |
| | $ 1,115,801 | $ 1,176,529 | $ 220,228 | $ 207,466 |
| Expenses | | | | |
| Cost of services | $ 73 | $ 85 | $ 6,106 | $ 6,057 |
| Assets | | | | |
| Accounts receivable | $ 144,361 | $ 73,856 | $ 68,439 | $ 52,756 |
| Accrued interest receivable | 1,695 | 1,271 | 11,812 | 13,721 |
| Loans, advances and investments | 1,668 | 1,484 | 1,212,694 | 1,242,236 |
| | $ 147,724 | $ 76,611 | $ 1,292,945 | $ 1,308,713 |
| Liabilities | | | | |
| Accounts and accrued interest payable | $ 327 | $ 316 | $ - | $ 47 |

The above transactions do not include support service arrangement transactions disclosed in Schedule 3.

The Department also had the following transactions with related parties for which no consideration was exchanged. The amounts for these related party transactions are estimated based on the costs incurred by the service provider to provide the service. These amounts are not recorded in the financial statements but are disclosed in Schedule 21.

*(thousands)*

| | Entities in the Ministry | | Other Entities | |
|---|---|---|---|---|
| | **2005** | **2004 Restated (Note 3)** | **2005** | **2004 Restated (Note 3)** |
| Expenses - incurred by others | | | | |
| Accommodation | $ - | $ - | $ 2,965 | $ 2,965 |
| Legal services | - | - | 2,059 | 1,993 |
| | $ - | $ - | $ 5,024 | $ 4,958 |

DEPARTMENT OF FINANCE

## ALLOCATED COSTS BY PROGRAM

**Schedule 21**

(thousands)

| Program | Expenses(1) | Expenses - Incurred by Others: Accomodation Costs | Expenses - Incurred by Others: Legal Services | Vacation Pay | Valuation Adjustments: Banked Overtime | Valuation Adjustments: Doubtful Accounts | Pension Provisions | Total 2005 | Total 2004 Restated (Note 3) |
|---|---|---|---|---|---|---|---|---|---|
| Ministry support services | $ 9,739 | $ 571 | $ 24 | $ 1 | $ 29 | $ - | $ - | $ 10,364 | $ 9,949 |
| Fiscal planning and accountability | 8,251 | 243 | 152 | (67) | 27 | - | - | 8,606 | 8,012 |
| Pensions, insurance and financial institutions | 5,950 | 104 | 631 | (20) | - | - | - | 6,665 | 5,760 |
| Treasury management | 2,151 | 70 | 59 | 36 | - | (58) | - | 2,258 | 2,205 |
| Long term revenue and investment policy | 846 | - | 20 | 58 | - | - | - | 924 | 609 |
| Revenue collection and rebates | 22,589 | 1,582 | 46 | (32) | - | (519) | - | 23,666 | 25,805 |
| Investment | 14,977 | 305 | 181 | (55) | 13 | - | - | 15,421 | 12,957 |
| Risk management and insurance | 1,212 | 90 | 946 | (38) | 28 | - | - | 2,238 | 2,151 |
| Debt servicing costs and pension provisions | 394,778 | - | - | - | - | - | 6,541 | 401,319 | 353,674 |
| | $ 460,493 | $ 2,965 | $ 2,059 | $ (117) | $ 97 | $ (577) | $ 6,541 | $ 471,461 | $ 421,122 |

1) Expenses - directly incurred as per Statement of Operations, excluding valuation adjustments.

# ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Alberta Heritage Foundation for Medical Research Endowment Fund as at March 31, 2005 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## BALANCE SHEET

March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 871,419 | $ 848,503 |
| Administration expense receivable | 22 | 26 |
| | $ 871,441 | $ 848,529 |
| **Endowment and Retained Earnings** | | |
| Endowment (Note 6) | $ 300,000 | $ 300,000 |
| Retained earnings (Note 6) | 571,441 | 548,529 |
| | $ 871,441 | $ 848,529 |

## STATEMENT OF INCOME AND RETAINED EARNINGS

Year Ended March 31, 2005 *(thousands)*

| | Budget | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Income** | | | |
| Net investment income (Note 7) | $ 29,721 | $ 72,912 | $ 72,368 |
| **Expenses** | | | |
| Transfers to the Alberta Heritage Foundation for Medical Research | 55,000 | 50,000 | 50,000 |
| **Net income (loss)** | $ (25,279) | 22,912 | 22,368 |
| **Retained earnings at beginning of year** | | 548,529 | 526,161 |
| **Retained earnings at end of year** | | $ 571,441 | $ 548,529 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## STATEMENT OF CASH FLOWS

Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Operating transactions** | | |
| Net income | $ 22,912 | $ 22,368 |
| Non-cash items included in net income | (9,751) | (4,905) |
| | 13,161 | 17,463 |
| Decrease in receivables | 4 | 564 |
| Decrease in payables | - | (5) |
| Cash provided by operating transactions | 13,165 | 18,022 |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 216,060 | 103,394 |
| Purchase of investments | (220,332) | (125,024) |
| Cash applied to investing transactions | (4,272) | (21,630) |
| **Increase (decrease) in cash** | 8,893 | (3,608) |
| **Cash at beginning of year** | 8,739 | 12,347 |
| **Cash at end of year** | $ 17,632 | $ 8,739 |
| **Consisting of Deposit in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 17,632 | $ 8,739 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005 *(thousands)*

## NOTE 1 AUTHORITY AND PURPOSE

The Alberta Heritage Foundation for Medical Research Endowment Fund ("the Fund") operates under the authority of the *Alberta Heritage Foundation for Medical Research Act*, Chapter A-21, Revised Statutes of Alberta 2000.

The purpose of the Fund is to invest the endowment made to the Fund. The Fund is managed with the objectives of providing an annual level of income for transfer to the Alberta Heritage Foundation for Medical Research while preserving the capital of the endowment over the long term. The portfolio is comprised of high quality fixed-income securities, equities, real estate, absolute return strategy investments and derivative financial instruments.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

**a) Portfolio investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

**b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 2 (continued)**

Gains and losses arising as a result of disposals of investments are included in the determination of investment income.

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures contracts, forward foreign exchange contracts and credit default swap contracts, are recorded at fair value.

**c) Foreign Currency**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**d) Investment Valuation**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Measurement uncertainty exists in the fair values reported for certain investments such as private equities, private real estate, absolute return strategies and other private placements. The fair value of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 2 (continued)**

Fair values of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.
(ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
(iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analysis.
(iv) The fair value of real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including the replacement cost, direct comparison, direct capitalization of earnings and discounted cash flows.
(v) The fair value of absolute return strategy investments are estimated by external managers.
(vi) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.
(vii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 5, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.
(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
(iv) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## NOTE 3 PORTFOLIO INVESTMENTS (Schedules A to E)

*(thousands)*

| | 2005 Cost | 2005 Fair Value | 2005 % | 2004 Cost | 2004 Fair Value | 2004 % |
|---|---|---|---|---|---|---|
| **Fixed-Income Securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 17,632 | $ 17,632 | 1.9 | $ 8,739 | $ 8,739 | 1.0 |
| Canadian Dollar Public Bond Pool (b) | 192,726 | 195,135 | 21.4 | 197,301 | 201,362 | 22.4 |
| Private Mortgage Pool (c ) | 29,681 | 32,935 | 3.6 | 30,267 | 33,837 | 3.8 |
| Overlay Pool (d ) | 1,820 | 1,822 | 0.2 | - | - | - |
| | 241,859 | 247,524 | 27.1 | 236,307 | 243,938 | 27.2 |
| **Canadian Equities (Schedule B)** | | | | | | |
| Domestic Passive Equity Pooled Fund (e) | 76,956 | 76,821 | 8.4 | 97,158 | 97,110 | 10.8 |
| Canadian Pooled Equity Fund (f) | 38,735 | 46,282 | 5.1 | 50,693 | 58,917 | 6.6 |
| External Managers: | | | | | | |
| Canadian Equity Enhanced Index Pool (g) | 24,741 | 27,077 | 3.0 | - | - | - |
| Canadian Large Cap Pool (h) | 12,385 | 13,627 | 1.5 | 51,900 | 59,112 | 6.6 |
| Canadian Small Cap Pool | - | - | - | 3,274 | 4,469 | 0.5 |
| Growing Equity Income Pool (i) | 10,878 | 12,931 | 1.4 | 15,106 | 15,839 | 1.8 |
| Canadian Multi-Cap Pool (j) | 11,456 | 11,465 | 1.3 | - | - | - |
| | 175,151 | 188,203 | 20.7 | 218,131 | 235,447 | 26.3 |
| Overlay Pool Canadian futures contracts (d) | (9,300) | (9,300) | (1.0) | - | - | - |
| | 165,851 | 178,903 | 19.7 | 218,131 | 235,447 | 26.3 |
| **United States Equities (Schedule C)** | | | | | | |
| S&P 500 Index Fund (k) | 114,362 | 115,415 | 12.7 | 74,100 | 75,931 | 8.5 |
| External Managers: | | | | | | |
| US Large Cap Equity Pool | 9 | 9 | - | 56,944 | 56,892 | 6.3 |
| US Small/Mid Cap Equity Pool (l) | 19,392 | 20,330 | 2.2 | 16,026 | 18,370 | 2.0 |
| Portable Alpha United States Equity Pool (m) | 25,408 | 24,708 | 2.7 | - | - | - |
| Growing Equity Income Pool (i) | 2,074 | 2,060 | 0.2 | - | - | - |
| | 161,245 | 162,522 | 17.8 | 147,070 | 151,193 | 16.8 |
| Overlay Pool US futures contracts (d) | 9,349 | 9,349 | 1.0 | - | - | - |
| | 170,594 | 171,871 | 18.8 | 147,070 | 151,193 | 16.8 |
| **Non-North American Equities (Schedule D)** | | | | | | |
| External Managers: | | | | | | |
| EAFE Core Equity Pool (n) | 87,687 | 87,044 | 9.5 | 78,090 | 79,261 | 8.8 |
| EAFE Plus Equity Pool (n) | 43,936 | 44,076 | 4.8 | 37,085 | 39,292 | 4.4 |
| EAFE Passive Equity Pool (o) | 27,817 | 34,351 | 3.8 | 32,512 | 41,746 | 4.6 |
| Emerging Market Equity Pool (p) | 9,257 | 10,185 | 1.1 | - | - | - |
| | 168,697 | 175,656 | 19.2 | 147,687 | 160,299 | 17.8 |
| **Real Estate (Schedule E)** | | | | | | |
| Private Real Estate Pool (q) | 66,365 | 80,152 | 8.8 | 58,197 | 64,758 | 7.2 |
| Foreign Private Real Estate Pool (r) | 3,162 | 3,000 | 0.3 | - | - | - |
| | 69,527 | 83,152 | 9.1 | 58,197 | 64,758 | 7.2 |
| **Absolute Return Strategies** | | | | | | |
| External Managers: | | | | | | |
| Absolute Return Strategy Pool (s) | 44,279 | 43,906 | 4.8 | 36,819 | 36,453 | 4.1 |
| **Private Equity and Income (t)** | | | | | | |
| Private Equity Pools | 6,395 | 6,963 | 0.8 | 4,292 | 5,116 | 0.6 |
| Private Income Pool | 4,217 | 4,154 | 0.5 | - | - | - |
| | 10,612 | 11,117 | 1.3 | 4,292 | 5,116 | 0.6 |
| **Total Investments (u)** | $ 871,419 | $ 912,129 | 100.0 | $ 848,503 | $ 897,204 | 100.0 |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

The Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | % Ownership | |
|---|---|---|
| | **2005** | **2004** |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 2.2 | 2.4 |
| Canadian Multi-Cap Pool | 5.0 | - |
| Canadian Pooled Equity Fund | 4.3 | 5.7 |
| Domestic Passive Equity Pooled Fund | 3.2 | 4.1 |
| Foreign Private Equity Pool (02) | 3.5 | 3.5 |
| Foreign Private Real Estate Pool | 6.4 | - |
| Growing Equity Income Pool | 5.0 | 6.2 |
| Overlay Pool | 2.6 | - |
| Private Equity Pool | 6.6 | 6.6 |
| Private Equity Pool (02) | 5.2 | 5.3 |
| Private Equity Pool (04) | 5.5 | - |
| Private Income Pool | 1.8 | 2.6 |
| Private Mortgage Pool | 2.7 | 2.8 |
| Private Real Estate Pool | 2.8 | 2.9 |
| Standard & Poor's 500 Index Fund | 6.2 | 6.0 |
| Portable Alpha United States Equity Pool | 6.9 | - |
| | | |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 6.4 | 6.4 |
| Canadian Equity Enhanced Equity Pool | 5.1 | - |
| Canadian Large Cap Equity Pool | 0.6 | 1.9 |
| Canadian Small Cap Equity Pool | - | 0.7 |
| EAFE Core Equity Pool | 2.8 | 2.6 |
| EAFE Passive Equity Pool | 7.5 | 6.2 |
| EAFE Plus Equity Pool | 2.9 | 2.6 |
| Emerging Markets Equity Pool | 2.4 | - |
| US Large Cap Equity Pool | - | 2.9 |
| US Small/Mid Cap Equity Pool | 2.2 | 2.7 |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12% (2004: 10%); and over 20 years: 16% (2004: 18%).

(c) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%); 1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% (2004: 20%); and over 20 years: 21% (2004: 24%).

(d) The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to US equities.

(e) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

(f) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection, while remaining sector neutral.

## ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

(g) The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.

(h) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

(i) The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income to client portfolios by investing in mature companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well capitalized companies. The performance of the pool is measured against the total return of a custom S&P/TSX Composite Index for dividend paying stocks.

(j) The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.

(k) Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 index. The performance objective is to provide returns comparable to the total return of the S&P 500 index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3(e)).

(l) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

(m) The Portable Alpha United States Equity Pool consists of futures and swap contracts which provide exposure to the U.S. equity market by replicating the S&P 500 Index and investments in value added absolute return strategies. The performance objective is to provide returns higher than the total return of the Standard & Poor's (S&P) 500 Index over a four-year period.

(n) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

(o) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicate the MSCI EAFE index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.

(p) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.

(q) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

(r) The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5.0%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.

(s) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6.0%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

(t) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02, PEP04, the Foreign Private Equity Pool 2002 and the Private Income Pool. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool allows unit holders to participate as equity investors in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%

(u) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and are temporary in nature.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## NOTE 4 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn an optimal financial return at an acceptable level of risk, management of the Fund established the following long-term policy asset mix for the 2004-2005 fiscal year:

| | |
|---|---|
| Fixed-income securities | 30% to 20% |
| Equities | 70% to 80% |

Risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

**NOTE 5 (continued)**

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

*(thousands)*

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Fair Value (b) | Notional Amount (a) | Fair Value (b) |
| Equity index swap contracts | 66% | 34% | - | $ 125,496 | $ 508 | $ 90,928 | $ (631) |
| Forward foreign exchange contracts | 100% | - | - | 69,421 | 946 | 42,946 | 352 |
| Interest rate swap contracts | 38% | 49% | 13% | 40,354 | (1,015) | 55,590 | (2,473) |
| Cross-currency interest rate swaps | 8% | 33% | 59% | 42,907 | 520 | 27,604 | (2,869) |
| Credit default swap contracts | 33% | 11% | 56% | 10,252 | 106 | 3,724 | (31) |
| Equity index futures contracts | 100% | - | - | 22,795 | 471 | 663 | 72 |
| Bond index swap contracts | 100% | - | - | 3,793 | 26 | 2,849 | 70 |
| | | | | $ 315,018 | $ 1,562 | $ 224,304 | $ (5,510) |

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in Note 2 (e).

## NOTE 6 ENDOWMENT AND RETAINED EARNINGS

The endowment was received from the Alberta Heritage Savings Trust Fund on March 31, 1980. The Alberta Heritage Foundation for Medical Research Act provides that money required by the Foundation for the furtherance of its objectives shall be paid from the Fund, but no money shall be paid out of the Fund if the payment would result in the value of the assets of the Fund, at cost, being less than the endowment received by the Fund.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## NOTE 7 NET INVESTMENT INCOME (LOSS)

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Deposits and fixed-income securities | $ 14,806 | $ 17,351 |
| Canadian equities | 32,336 | 34,638 |
| United States equities | (228) | 2,985 |
| Non-North American equities | 18,448 | 9,892 |
| Real estate | 4,832 | 3,721 |
| Absolute return strategies | 2,308 | 2,713 |
| Private equities and income | 595 | 1,225 |
| **Investment income** | 73,097 | 72,525 |
| Direct administrative expenses (Note 8) | (185) | (157) |
| **Net investment income** | $ 72,912 | $ 72,368 |

Investment income is comprised of interest, dividends, amortization of discount or premium, swap income, security lending income and realized gains and losses, net of write-downs on investments. The Fund's share of income (loss) earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

The investment income for the year ended March 31, 2005 includes writedowns of $2,022 (2004: $245).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expenses include investment management, cash management and safekeeping costs and other expenses charged on a cost-recovery basis directly by Alberta Finance. The Fund's total administrative expenses for the period, including amounts deducted directly from investment income of pooled investment funds is as follows:

| | 2005 | 2004 |
|---|---|---|
| Direct fund expenses (Note 7) | $ 185 | $ 157 |
| Externally managed investment pools | 1,240 | 922 |
| Internally managed investment pools | 258 | 232 |
| | $ 1,683 | $ 1,311 |
| Expenses as a percentage of net assets at fair value | 0.185% | 0.146% |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## NOTE 9 INVESTMENT PERFORMANCE

The following is a summary of the investment performance results attained by the Fund determined on a fair value basis:

| | One Year Return | Five Year Compound Annualized Return |
|---|---|---|
| **Time-weighted rates of return** | | |
| Overall actual return | 7.5% | 1.4% |
| Benchmark return* | 6.0% | 1.0% |

*The overall benchmark return for year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

March 31, 2005 *(thousands)*

| | | Fund's share 2005 | | Fund's share 2004 |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 19,780 | $ 19,780 | $ 9,058 | $ 9,058 |
| **Fixed-income securities (a)** | | | | |
| Corporate, public and private | 115,260 | 117,858 | 130,390 | 134,320 |
| Government of Canada, direct and guaranteed | 58,545 | 58,591 | 47,786 | 47,980 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 111 | 119 | 136 | 149 |
| Other provinces | 44,236 | 47,133 | 46,649 | 50,025 |
| Municipal | 2,358 | 2,474 | 2,617 | 2,735 |
| | 220,510 | 226,175 | 227,578 | 235,209 |
| Receivable from sale of investments and accrued investment income | 2,700 | 2,700 | 2,523 | 2,523 |
| Accounts payable and accrued liabilities | (1,131) | (1,131) | (2,852) | (2,852) |
| | 1,569 | 1,569 | (329) | (329) |
| | $ 241,859 | $ 247,524 | $ 236,307 | $ 243,938 |

(a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.59% per annum (2004: 4.39% per annum) and the following term structure based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| under 1 year | 3 | 3 |
| 1 to 5 years | 35 | 37 |
| 5 to 10 years | 33 | 30 |
| 10 to 20 years | 12 | 11 |
| over 20 years | 17 | 19 |
| | 100 | 100 |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES Schedule B

March 31, 2005 *(thousands)*

| | | Fund's share 2005 | | Fund's share 2004 |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 1,347 | $ 1,347 | $ 1,697 | $ 1,697 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 11,821 | 11,216 | 17,710 | 16,705 |
| Consumer staples | 6,987 | 7,754 | 8,751 | 9,431 |
| Energy | 29,885 | 36,319 | 29,005 | 34,413 |
| Financials | 52,983 | 57,366 | 68,423 | 76,603 |
| Health care | 2,890 | 2,379 | 5,168 | 4,841 |
| Industrials | 8,722 | 9,649 | 17,325 | 17,899 |
| Information technology | 10,115 | 9,565 | 15,472 | 17,388 |
| Materials | 24,136 | 25,539 | 36,023 | 38,450 |
| Telecommunication services | 10,245 | 10,854 | 11,947 | 11,147 |
| Utilities | 2,301 | 2,454 | 8,211 | 8,478 |
| | 160,085 | 173,095 | 218,035 | 235,355 |
| Small Cap Pooled Fund | 3,446 | 3,488 | 56 | 52 |
| Receivable from sale of investments and accrued investment income | 2,976 | 2,976 | 926 | 926 |
| Accounts payable and accrued liabilities | (2,003) | (2,003) | (2,583) | (2,583) |
| | 973 | 973 | (1,657) | (1,657) |
| | $ 165,851 | $ 178,903 | $ 218,131 | $ 235,447 |

(a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $70,480 (2004: $68,220).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

March 31, 2005 *(thousands)*

| | | Fund's share 2005 | | Fund's share 2004 |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 2,440 | $ 2,440 | $ 2,300 | $ 2,300 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 19,591 | 20,167 | 23,443 | 24,305 |
| Consumer staples | 16,241 | 15,965 | 14,297 | 14,116 |
| Energy | 13,546 | 14,808 | 8,698 | 8,696 |
| Financials | 34,925 | 34,373 | 28,828 | 30,775 |
| Health care | 22,541 | 22,055 | 19,428 | 18,283 |
| Industrials | 20,864 | 21,408 | 16,424 | 17,042 |
| Information technology | 25,957 | 25,746 | 22,595 | 23,998 |
| Materials | 6,373 | 6,706 | 4,752 | 5,523 |
| Telecommunication services | 4,849 | 4,680 | 4,488 | 4,256 |
| Utilities | 5,835 | 6,091 | 3,478 | 3,560 |
| | 170,722 | 171,999 | 146,431 | 150,554 |
| Receivable from sale of investments and accrued investment income | 1,337 | 1,337 | 573 | 573 |
| Accounts payable and accrued liabilities | (3,905) | (3,905) | (2,234) | (2,234) |
| | (2,568) | (2,568) | (1,661) | (1,661) |
| | $ 170,594 | $ 171,871 | $ 147,070 | $ 151,193 |

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling $77,811 (2004: $23,371).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES

**Schedule D**

March 31, 2005 *(thousands)*

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 3,308 | $ 3,308 | $ 3,152 | $ 3,152 |
| **Public equities (a)** | | | | |
| Consumer discretionary | 22,447 | 22,620 | 22,142 | 24,517 |
| Consumer staples | 9,724 | 9,874 | 11,281 | 11,739 |
| Energy | 13,622 | 14,829 | 11,718 | 12,026 |
| Financials | 41,421 | 44,639 | 33,732 | 37,879 |
| Health care | 10,762 | 10,287 | 12,616 | 12,220 |
| Industrials | 19,015 | 20,380 | 16,413 | 18,115 |
| Information technology | 8,752 | 8,562 | 8,154 | 9,792 |
| Materials | 13,538 | 14,808 | 10,813 | 12,171 |
| Telecommunication services | 14,722 | 14,420 | 11,864 | 12,368 |
| Utilities | 7,080 | 7,389 | 5,645 | 6,163 |
| | 161,083 | 167,808 | 144,378 | 156,990 |
| Emerging markets pooled funds | 4,000 | 4,234 | - | - |
| Receivable from sale of investments and accrued investment income | 2,124 | 2,124 | 1,670 | 1,670 |
| Accounts payable and accrued liabilities | (1,818) | (1,818) | (1,513) | (1,513) |
| | 306 | 306 | 157 | 157 |
| | $ 168,697 | $ 175,656 | $ 147,687 | $ 160,299 |

a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| United Kingdom | $ 36,152 | $ 36,354 | $ 35,184 | $ 36,158 |
| Japan | 29,994 | 29,004 | 26,583 | 30,192 |
| France | 15,505 | 16,582 | 13,638 | 14,671 |
| Germany | 11,375 | 11,902 | 9,885 | 10,656 |
| Switzerland | 10,174 | 10,588 | 11,823 | 12,317 |
| Netherlands | 8,799 | 9,061 | 8,226 | 8,518 |
| Australia | 6,436 | 7,584 | 6,166 | 7,647 |
| Italy | 5,684 | 6,458 | 6,435 | 6,906 |
| Spain | 4,483 | 4,895 | 3,698 | 4,185 |
| Sweden | 4,154 | 4,476 | 2,520 | 2,932 |
| Other | 28,327 | 30,904 | 20,220 | 22,808 |
| | $ 161,083 | $ 167,808 | $ 144,378 | $ 156,990 |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN REAL ESTATE — Schedule E

March 31, 2005 *(thousands)*

| | 2005 Cost | Fund's share 2005 Fair Value | 2004 Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 33 | $ 33 | $ 79 | $ 79 |
| **Real estate (a)** | | | | |
| Office | 31,149 | 36,450 | 24,685 | 28,809 |
| Retail | 24,783 | 32,457 | 25,268 | 27,428 |
| Industrial | 5,444 | 6,332 | 3,836 | 4,316 |
| Residential | 3,694 | 3,618 | 3,597 | 3,394 |
| | 65,070 | 78,857 | 57,386 | 63,947 |
| Foreign Private Real Estate Pool | 3,162 | 3,000 | - | - |
| Participation units | 1,156 | 1,156 | 570 | 570 |
| Accrued income and accounts receivable | 106 | 106 | 162 | 162 |
| | $ 69,527 | $ 83,152 | $ 58,197 | $ 64,758 |

a) The following is a summary of real estate investments by geographic location:

| | 2005 Cost | Fund's share 2005 Fair Value | 2004 Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| Ontario | $ 41,651 | $ 52,477 | $ 42,410 | $ 47,305 |
| Alberta | 13,209 | 16,373 | 13,750 | 15,318 |
| Quebec | 8,657 | 8,295 | - | - |
| British Columbia | 1,553 | 1,712 | 1,226 | 1,324 |
| | $ 65,070 | $ 78,857 | $ 57,386 | $ 63,947 |

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENT RETURNS

**Schedule F**

Year Ended March 31, 2005

The Fund uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

| | One Year Return | | | | | 5 Year Compound Annualized |
|---|---|---|---|---|---|---|
| **Time-weighted Rates of Return** | **2005** | **2004** | **2003** | **2002** | **2001** | **Return** |
| **Short-term fixed income** | **2.3** | **3.0** | **2.7** | **3.9** | **5.9** | **3.6** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *5.7* | *3.5* |
| **Long-term fixed income** | **5.6** | **11.6** | **9.6** | **5.9** | **9.3** | **8.4** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *8.7* | *7.7* |
| **Canadian equities** | **15.4** | **36.3** | **(17.4)** | **3.7** | **(16.5)** | **2.4** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *(18.6)* | *2.0* |
| **United States equities** | **(1.7)** | **22.2** | **(30.5)** | **1.6** | **(14.4)** | **(6.2)** |
| *S&P 1500 Index* | *(1.0)* | *20.5* | *(30.7)* | *1.6* | *(15.1)* | *(6.5)* |
| **Non-North American equities** | **7.4** | **40.9** | **(29.1)** | **(5.8)** | **(23.2)** | **(4.9)** |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(19.6)* | *(4.7)* |
| **Real estate** | **16.9** | **7.5** | **9.8** | **7.2** | **9.7** | **10.2** |
| *Consumer Price Index (CPI) plus 5%* | *7.1* | *5.7* | *8.9* | *9.9* | *11.9* | *8.7* |
| **Absolute return strategies** | **5.5** | **10.7** | **1.6** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *6.7* | *4.7* | *n/a* | *n/a* | *n/a* |
| **Private equities** | **(0.9)** | **1.1** | **(3.3)** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 8%* | *10.1* | *8.7* | *5.7* | *n/a* | *n/a* | *n/a* |
| **Private income** | **5.3** | **n/a** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *n/a* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Overall** | **7.5** | **24.0** | **(13.4)** | **2.4** | **(9.2)** | **1.4** |
| ***Policy Benchmark*** | ***6.0*** | ***23.3*** | ***(13.7)*** | ***2.7*** | ***(9.5)*** | ***1.0*** |

# ALBERTA HERITAGE SAVINGS TRUST FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Alberta Heritage Savings Trust Fund as at March 31, 2005 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

ALBERTA HERITAGE SAVINGS TRUST FUND

## BALANCE SHEET

March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 11,417,548 | $ 11,507,117 |
| Accrued investment income | 7,008 | 7,542 |
| Administration expense receivable | 281 | 310 |
| | $ 11,424,837 | $ 11,514,969 |
| **Liabilities and Fund Equity** | | |
| Liabilities | | |
| Accounts payable | $ 7 | $ 42 |
| Due to the General Revenue Fund | 62,388 | 152,485 |
| | 62,395 | 152,527 |
| Fund equity (Note 6) | 11,362,442 | 11,362,442 |
| | $ 11,424,837 | $ 11,514,969 |

## STATEMENT OF OPERATIONS

Year Ended March 31, 2005 *(thousands)*

| | Budget | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Net income (Note 7)** | $ 644,241 | $ 1,091,903 | $ 1,133,485 |
| **Transfers to the General Revenue Fund (Note 6)** | 644,241 | 1,091,903 | 1,133,485 |
| **Net change in fund equity (Note 6)** | $ - | - | - |
| **Fund equity at beginning of year** | | 11,362,442 | 11,362,442 |
| **Fund equity at end of year** | | $ 11,362,442 | $ 11,362,442 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SAVINGS TRUST FUND

## STATEMENT OF CASH FLOWS

Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Operating transactions** | | |
| Net income | $ 1,091,903 | $ 1,133,485 |
| Non-cash items included in net income | (208,924) | (166,266) |
| | 882,979 | 967,219 |
| Decrease in accounts receivable | 563 | 8,295 |
| Increase (decrease) in accounts payable | (35) | 42 |
| Cash provided by operating transactions | 883,507 | 975,556 |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 2,716,273 | 1,576,492 |
| Purchase of investments | (2,460,083) | (1,707,900) |
| Cash provided by (applied to) investing transactions | 256,190 | (131,408) |
| **Transfers** | | |
| Transfers to the General Revenue Fund | (1,091,903) | (1,133,485) |
| Increase (decrease) in amounts due to the General Revenue Fund | (90,097) | 152,485 |
| Cash applied to transfers | (1,182,000) | (981,000) |
| **Decrease in cash** | (42,303) | (136,852) |
| **Cash at beginning of year** | 113,662 | 250,514 |
| **Cash at end of year** | $ 71,359 | $ 113,662 |
| **Consisting of Deposits in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 71,359 | $ 113,662 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SAVINGS TRUST FUND

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005 (*thousands*)

## NOTE 1 AUTHORITY AND MISSION

The Alberta Heritage Savings Trust Fund operates under the authority of the *Alberta Heritage Savings Trust Fund Act* (the Act), Chapter A-23, Revised Statutes of Alberta 2000, as amended.

The preamble to the *Act* describes the mission of the Fund as follows:

*"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."*

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

**(a) Portfolio Investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments in loans are recorded at cost less any allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a specific provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 2 (continued)**

**(b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability. When a loan becomes impaired, recognition of interest income in accordance with the terms of the original loan agreement ceases. Any subsequent payments received on an impaired loan are applied to reduce the loan's book value.

Gains and losses arising as a result of disposals of investments are included in the determination of investment income.

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures, forward foreign exchange contracts and credit default swap contracts are recorded at fair value.

**(c) Foreign Currency**

Foreign currency transactions, which are translated into Canadian dollars using average rates of exchange; except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**(d) Investment Valuation**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 2 (continued)**

Measurement uncertainty exists in the fair values reported for certain investments such as private equities; private real estate, loans, absolute return strategies and other private placements. The fair values of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Fair value of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.
(ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
(iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analysis.
(iv) The fair value of real estate investments is reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of approaches to determine fair value including the replacement cost, direct comparison, direct capitalization of earnings and the discounted cash flows.
(v) The fair value of Absolute Return Strategy Pool investments are estimated by external managers.
(vi) The fair value of loans is estimated by management based on the present value of discounted cash flows.
(vii) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.
(viii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**(e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 4, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated fair value of derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.
(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
(iv) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

ALBERTA HERITAGE SAVINGS TRUST FUND

## NOTE 3 PORTFOLIO INVESTMENTS

*(thousands)*

| | 2005 Cost | 2005 Fair Value | 2005 % | 2004 Cost | 2004 Fair Value | 2004 % |
|---|---|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 71,359 | $ 71,359 | 0.6 | $ 113,662 | $ 113,662 | 0.9 |
| Canadian Dollar Public Bond Pool (b) | 3,094,268 | 3,154,021 | 25.5 | 3,135,075 | 3,223,579 | 25.7 |
| Bonds, notes & short-term paper, directly held (c) | 23,067 | 23,742 | 0.2 | 23,799 | 25,304 | 0.2 |
| Private Mortgage Pool (d) | 518,924 | 532,357 | 4.3 | 544,000 | 558,409 | 4.5 |
| Provincial corporation debentures, directly held (e) | 88,340 | 132,261 | 1.1 | 94,656 | 150,125 | 1.2 |
| Loans, directly held (f) | 93,298 | 93,298 | 0.8 | 93,144 | 93,144 | 0.7 |
| Overlay Pool (g) | 24,529 | 24,555 | 0.2 | - | - | - |
| | 3,913,785 | 4,031,593 | 32.7 | 4,004,336 | 4,164,223 | 33.2 |
| **Public Equities** | | | | | | |
| **Canadian (Schedule B)** | | | | | | |
| Domestic Passive Equity Pooled Fund (h) | 868,241 | 989,240 | 8.1 | 989,162 | 1,152,226 | 9.2 |
| Canadian Pooled Equity Fund (i) | 491,455 | 605,425 | 4.9 | 581,354 | 699,381 | 5.6 |
| External Managers: | | | | | | |
| Canadian Equity Enhanced Index Pool (j) | 292,113 | 319,695 | 2.6 | - | - | - |
| Canadian Large Cap Equity Pool (k) | 163,796 | 184,242 | 1.5 | 576,697 | 674,266 | 5.4 |
| Canadian Small Cap Equity Pool | - | - | - | 36,611 | 51,135 | 0.4 |
| Growing Equity Income Pool (l) | 128,558 | 152,821 | 1.3 | 182,284 | 191,135 | 1.5 |
| Canadian Multi-Cap Pool (m) | 138,847 | 138,958 | 1.1 | - | - | - |
| | 2,083,010 | 2,390,381 | 19.5 | 2,366,108 | 2,768,143 | 22.1 |
| Overlay Pool Canadian futures contracts (g) | (125,308) | (125,308) | (1.0) | - | - | - |
| | 1,957,702 | 2,265,073 | 18.5 | 2,366,108 | 2,768,143 | 22.1 |
| **United States (Schedule C)** | | | | | | |
| S&P 500 Index Fund (n) | 1,179,505 | 1,284,273 | 10.4 | 914,333 | 1,031,374 | 8.2 |
| External Managers: | | | | | | |
| US Small/Mid Cap Equity Pool (o) | 237,574 | 240,550 | 2.0 | 224,758 | 244,619 | 1.9 |
| US Large Cap Equity Pool | 77 | 77 | - | 687,476 | 685,839 | 5.5 |
| Portable Alpha United States Equity Pool (p | 326,700 | 316,340 | 2.6 | - | - | - |
| Growing Equity Income Pool (l) | 24,513 | 24,350 | 0.2 | - | - | - |
| | 1,768,369 | 1,865,590 | 15.2 | 1,826,567 | 1,961,832 | 15.6 |
| Overlay Pool US futures contracts (g) | 125,969 | 125,969 | 1.0 | - | - | - |
| | 1,894,338 | 1,991,559 | 16.2 | 1,826,567 | 1,961,832 | 15.6 |
| **Non-North American (Schedule D)** | | | | | | |
| External Managers: | | | | | | |
| EAFE Core Equity Pool (q) | 926,654 | 977,096 | 8.0 | 949,210 | 1,027,313 | 8.2 |
| EAFE Plus Equity Pool (q) | 475,764 | 490,505 | 4.0 | 460,474 | 500,339 | 4.0 |
| EAFE Passive Equity Pool (r) | 267,922 | 364,905 | 3.0 | 366,816 | 525,190 | 4.2 |
| Emerging Markets Equity Pool (s) | 128,567 | 141,465 | 1.1 | - | - | - |
| | 1,798,907 | 1,973,971 | 16.1 | 1,776,500 | 2,052,842 | 16.4 |
| **Real Estate (Schedule E)** | | | | | | |
| Private Real Estate Pool (t) | 966,041 | 1,148,626 | 9.4 | 871,959 | 949,771 | 7.6 |
| Foreign Private Real Estate Pool (u) | 43,161 | 40,948 | 0.3 | - | - | - |
| | 1,009,202 | 1,189,574 | 9.7 | 871,959 | 949,771 | 7.6 |
| **Absolute Return Strategies** | | | | | | |
| External Managers | | | | | | |
| Absolute Return Strategy Pool (v) | 615,053 | 610,593 | 5.0 | 512,075 | 507,721 | 4.0 |
| **Private Equity (w)** | | | | | | |
| Private Equity Pools | 166,624 | 153,374 | 1.3 | 135,934 | 122,734 | 1.0 |
| Private Income Pool | 61,937 | 61,012 | 0.5 | 13,638 | 13,624 | 0.1 |
| | 228,561 | 214,386 | 1.8 | 149,572 | 136,358 | 1.1 |
| **Total Investments (x)** | $11,417,548 | $12,276,749 | 100.0 | $11,507,117 | $12,540,890 | 100.0 |

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 3 (continued)**

The majority of the Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | *% Ownership* | |
|---|---|---|
| | **2005** | **2004** |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 35.6 | 38.3 |
| Canadian Multi-Cap Pool | 60.2 | - |
| Canadian Pooled Equity Fund | 56.3 | 67.8 |
| Domestic Passive Equity Pooled Fund | 41.7 | 49.2 |
| Foreign Private Equity Pool (02) | 43.8 | 43.8 |
| Foreign Private Real Estate Pool | 87.1 | - |
| Growing Equity Income Pool | 59.1 | 75.3 |
| Overlay Pool | 35.5 | - |
| Private Equity Pool | 13.6 | 13.6 |
| Private Equity Pool (98) | 100.0 | 100.0 |
| Private Equity Pool (02) | 62.1 | 62.1 |
| Private Equity Pool (04) | 77.0 | - |
| Private Income Pool | 25.7 | 38.8 |
| Private Mortgage Pool | 44.2 | 46.6 |
| Private Real Estate Pool | 40.4 | 43.1 |
| Standard & Poor's 500 Index Fund | 69.3 | 82.1 |
| Portable Alpha United States Equity Pool | 87.9 | - |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 88.5 | 88.5 |
| Canadian Large Cap Equity Pool | 8.0 | 21.9 |
| Canadian Small Cap Equity Pool | - | 8.2 |
| Canadian Equity Enhanced Index Pool | 60.2 | - |
| EAFE Core Equity Pool | 31.2 | 33.5 |
| EAFE Passive Equity Pool | 79.9 | 78.4 |
| EAFE Plus Equity Pool | 32.1 | 33.4 |
| Emerging Markets Equity Pool | 33.6 | - |
| US Large Cap Equity Pool | - | 35.2 |
| US Small/Mid Cap Equity Pool | 25.5 | 35.5 |

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 3 (continued)**

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12% (2004: 10%); and over 20 years: 16% (2004: 18%).

(c) As at March 31, 2005, fixed-income securities held directly by the Fund have an average effective market yield of 3.18% per annum (2004: 2.69% per annum). As at March 31, 2005, fixed-income securities have the following term structure based on principal amount: under two years: 100%.

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%); 1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% (2004: 20%); and over 20 years: 21% (2004: 24%).

e) As at March 31, 2005, Provincial corporation debentures have an average effective market yield of 7.51% per annum (2004: 7.10% per annum) and the following term structure based on principal amounts: 5 to 10 years: 100%.

(f) Investments in loans are recorded at cost. The fair value of loans is estimated by management based on the present value of discounted cash flows. As at March 31, 2005, investment in loans, at cost, include the Ridley Grain loan amounting to $91,245 (2004: $91,245) and the Vencap loan amounting to $2,053 (2004: $1,899). The increase in the carrying value of the Vencap loan resulted from amortization of the loan on a constant yield basis.

- Under the terms of the loan to Ridley Grain, 11% Participating First Mortgage Bonds due July 31, 2015, interest is compounded semi-annually and payable annually to the extent of available cash flow and any shortfall is to be deferred and capitalized. The principal of $91,245 and deferred interest is repayable on or before July 31, 2015. Deferred interest at March 31, 2005 amounted to $92,517 (2004: $88,415). Grain throughput volumes are the main determinant of profitability of the grain terminal and the value of the loan to the Fund. Due to the uncertainty of forecasting the grain throughput volumes, income from the participating bonds is recognized when it is measurable and collectable.

- The principal amount of the Vencap loan, amounting to $52,588, is due July 2046 and bears no interest.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 3 (continued)**

(g) The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to U.S. equities.

(h) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

(i) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection while remaining sector neutral.

(j) The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.

(k) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. The portfolios are actively managed by external managers with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

(l) The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income by investing in mature Canadian and US companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well capitalized companies. The performance of the pool is measured against the total return of a custom S&P/TSX Composite Index for dividend paying stocks.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 3 (continued)**

(m) The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.

(n) Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 Index. The performance objective is to provide returns comparable to the total return of the S&P 500 Index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3 (h)).

(o) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

(p) The Portable Alpha United States Equity Pool consists of futures and swap contracts which provide exposure to the U.S. equity market by replicating the S&P 500 Index and investments in value added absolute return strategies. The performance objective is to provide returns higher than the total return of the Standard & Poor's (S&P) 500 Index over a four-year period.

(q) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE Index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

(r) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicates the MSCI EAFE Index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.

(s) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.

(t) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies, which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 3 (continued)**

(u) The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.

(v) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

(w) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02, PEP04 and the Foreign Private Equity Pool 2002. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool invests in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%.

(x) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and is temporary in nature.

## NOTE 4 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 4 (continued)**

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.
(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

*(thousands)*

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Fair Value (b) | Notional Amount (a) | Fair Value (b) |
| Equity index swap contracts | 66% | 34% | - | $ 1,534,324 | $ 7,673 | $ 1,117,982 | $ (8,244) |
| Interest rate swap contracts | 39% | 49% | 12% | 491,031 | (12,449) | 684,837 | (30,484) |
| Forward foreign exchange contracts | 100% | - | - | 935,430 | 13,334 | 590,114 | 4,825 |
| Cross-currency interest rate swaps | 8% | 31% | 61% | 580,540 | 2,228 | 398,256 | (45,969) |
| Credit default swap contracts | 32% | 11% | 57% | 128,430 | 1,384 | 49,141 | (384) |
| Bond index swap contracts | 100% | - | - | 61,311 | 428 | 45,613 | 1,114 |
| Equity index futures contracts | 100% | - | - | 302,125 | 5,957 | 8,919 | 965 |
| | | | | $ 4,033,191 | $ 18,555 | $ 2,894,862 | $ (78,177) |

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in Note 2 (e).

## NOTE 5 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

The Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan of the Fund. In order to earn an optimal financial return at an acceptable level of risk, the 2004-2007 Business Plan proposed the following asset mix policy for the Endowment Portfolio.

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 5 (continued)**

| | 2004-05 | 2005-06 | 2006-07 |
|---|---|---|---|
| Public equities | 46.00% | 45.00% | 45.00% |
| Fixed income securities | 35.00% | 35.00% | 32.50% |
| Real estate | 10.00% | 10.00% | 10.00% |
| Absolute return strategies | 5.00% | 5.00% | 7.50% |
| Private equities | 4.00% | 5.00% | 5.00% |

Risk is reduced through asset class diversification, diversification within each asset class, quality and duration constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 4). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 4).

## NOTE 6 FUND EQUITY

Section 8 (2) of the *Alberta Heritage Savings Trust Fund Act* (the *Act*) states that the net income of the Heritage Fund less any amount retained in the Fund to maintain its value shall be transferred to the General Revenue Fund annually in a manner determined by the Minister of Finance.

Section 11(4) of the Act states that for fiscal years subsequent to 1999 and until the accumulated debt is eliminated in accordance with the *Fiscal Responsibility Act*, the Minister of Finance is not required to retain any income in the Heritage Fund to maintain its value, but may retain such amounts as the Minister of Finance considers advisable.

## NOTE 7 NET INCOME (LOSS)

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Deposit and fixed-income securities | $ 264,136 | $ 304,331 |
| Canadian equities | 450,950 | 509,551 |
| United States equities | 9,086 | 46,191 |
| Non-North American equities | 258,049 | 175,183 |
| Private equities and income | 11,109 | 7,934 |
| Real estate | 68,678 | 54,392 |
| Absolute return strategies | 32,098 | 38,069 |
| **Investment income** | 1,094,106 | 1,135,651 |
| Direct administrative expenses (Note 8) | (2,203) | (2,166) |
| **Net income** | $ 1,091,903 | $ 1,133,485 |

Investment income is comprised of interest, dividends, amortization of discount and premiums, swap income, security lending income and realized gains and losses, net of write-downs, on investments. The Fund's share of income earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

ALBERTA HERITAGE SAVINGS TRUST FUND

**NOTE 7 (continued)**

The investment income for the year ended March 31, 2005 includes writedowns totalling $34,425 (2004: $2,630).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expenses include investment management, cash management, safekeeping costs and other expenses charged on a cost-recovery basis directly from Alberta Finance. The Fund's total administrative expense for the period, including amounts deducted directly from investment income of pooled funds is as follows:

(thousands)

| | 2005 | 2004 |
|---|---|---|
| Direct fund expense (Note 7) | $ 2,203 | $ 2,166 |
| Externally managed investment pools | 14,792 | 12,338 |
| Internally managed investment pools | 3,713 | 3,425 |
| Total | $ 20,708 | $ 17,929 |
| Percent of net assets at fair value | 0.169% | 0.145% |

## NOTE 9 INVESTMENT PERFORMANCE (SCHEDULE F)

The following is a summary of the overall investment performance results attained by the Fund determined on a fair value basis:

| | One Year Return | Five Year Compound Annualized Return |
|---|---|---|
| **Time-weighted rates of return** | | |
| Overall actual return | 7.7% | 4.1% |
| Benchmark return* | 6.4% | 6.9% |

* The overall benchmark return for the year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns. The Fund is expected to generate a real rate of return of 4.5% over a moving five-year period based on the Fund's business plan. Over a five-year period, the annualized inflation rate was 2.4%. Therefore, the fund is expected to generate a nominal annualized rate of return of 6.9%.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

March 31, 2005 *(thousands)*

| | 2005 Cost | 2005 Fund's share Fair Value | 2004 Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 103,527 | $ 103,527 | $ 118,768 | $ 118,768 |
| **Fixed-income securities (a)** | | | | |
| Corporate, public and private | 1,890,339 | 1,905,009 | 2,130,560 | 2,165,983 |
| Government of Canada, direct and guaranteed | 960,687 | 968,395 | 783,122 | 793,410 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 1,781 | 1,931 | 2,159 | 2,377 |
| Other provinces | 712,581 | 761,815 | 745,529 | 801,819 |
| Municipal | 37,860 | 39,985 | 41,586 | 43,785 |
| Provincial corporation debentures | 88,340 | 132,261 | 94,656 | 150,125 |
| Loans | 93,298 | 93,298 | 93,144 | 93,144 |
| | 3,784,886 | 3,902,694 | 3,890,756 | 4,050,643 |
| Receivable from sale of investments and accrued investment income | 43,651 | 43,651 | 40,472 | 40,472 |
| Accounts payable and accrued liabilities | (18,279) | (18,279) | (45,660) | (45,660) |
| | 25,372 | 25,372 | (5,188) | (5,188) |
| | $ 3,913,785 | $ 4,031,593 | $ 4,004,336 | $ 4,164,223 |

(a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.84% per annum (2004: 4.53% per annum) and the following term structure based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| under 1 year | 3 | 3 |
| 1 to 5 years | 33 | 35 |
| 5 to 10 years | 36 | 32 |
| 10 to 20 years | 11 | 11 |
| over 20 years | 17 | 19 |
| | 100 | 100 |

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES — Schedule B

March 31, 2005 *(thousands)*

| | | Fund's share 2005 | | Fund's share 2004 |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 17,140 | $ 17,140 | $ 19,490 | $ 19,490 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 136,794 | 143,247 | 185,183 | 196,016 |
| Consumer staples | 81,341 | 98,161 | 90,335 | 110,909 |
| Energy | 357,358 | 459,663 | 317,651 | 404,651 |
| Financials | 637,357 | 725,438 | 769,038 | 901,733 |
| Health care | 30,952 | 30,464 | 51,479 | 56,827 |
| Industrials | 99,590 | 121,832 | 184,151 | 209,612 |
| Information technology | 118,285 | 121,644 | 161,932 | 204,279 |
| Materials | 276,563 | 322,935 | 381,880 | 451,810 |
| Telecommunication services | 123,781 | 138,568 | 133,260 | 131,202 |
| Utilities | 24,398 | 31,333 | 90,691 | 100,631 |
| | 1,886,419 | 2,193,285 | 2,365,600 | 2,767,670 |
| Small Cap Pooled Fund | 41,766 | 42,271 | 628 | 593 |
| Receivable from sale of investments and accrued investment income | 37,239 | 37,239 | 10,835 | 10,835 |
| Accounts payable and accrued liabilities | (24,862) | (24,862) | (30,445) | (30,445) |
| | 12,377 | 12,377 | (19,610) | (19,610) |
| | $ 1,957,702 | $ 2,265,073 | $ 2,366,108 | $ 2,768,143 |

(a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $907,201 (2004: $809,440).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

March 31, 2005 *(thousands)*

| | 2005 Cost | Fund's share 2005 Fair Value | 2004 Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 29,803 | $ 29,803 | $ 29,995 | $ 29,995 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 218,328 | 233,740 | 292,063 | 311,021 |
| Consumer staples | 177,873 | 184,501 | 175,500 | 183,849 |
| Energy | 151,561 | 171,637 | 107,832 | 112,968 |
| Financials | 387,321 | 398,319 | 357,904 | 400,188 |
| Health Care | 249,009 | 255,525 | 240,502 | 238,498 |
| Industrials | 233,052 | 248,242 | 204,356 | 220,671 |
| Information technology | 287,905 | 298,195 | 282,604 | 313,416 |
| Materials | 72,307 | 77,985 | 59,136 | 70,825 |
| Telecommunication services | 52,937 | 54,077 | 55,511 | 55,753 |
| Utilities | 65,324 | 70,617 | 43,449 | 46,933 |
| | 1,895,617 | 1,992,838 | 1,818,857 | 1,954,122 |
| Receivable from sale of investments and accrued investment income | 16,281 | 16,281 | 7,408 | 7,408 |
| Accounts payable and accrued liabilities | (47,363) | (47,363) | (29,693) | (29,693) |
| | (31,082) | (31,082) | (22,285) | (22,285) |
| | $ 1,894,338 | $ 1,991,559 | $ 1,826,567 | $ 1,961,832 |

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling $929,248 (2004: $317,461).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

March 31, 2005 *(thousands)*

| | 2005 Cost | 2005 Fund's share Fair Value | 2004 Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 37,408 | $ 37,408 | $ 40,551 | $ 40,551 |
| **Public equities (a)** | | | | |
| Consumer discretionary | 237,437 | 253,047 | 266,480 | 314,210 |
| Consumer staples | 101,731 | 109,365 | 135,141 | 150,389 |
| Energy | 143,749 | 165,802 | 140,245 | 154,046 |
| Financials | 439,381 | 500,068 | 405,030 | 484,429 |
| Health care | 111,514 | 113,706 | 150,885 | 156,468 |
| Industrials | 200,853 | 226,907 | 197,744 | 232,027 |
| Information technology | 91,900 | 94,916 | 97,954 | 125,276 |
| Materials | 145,507 | 166,576 | 130,807 | 155,861 |
| Telecommunication services | 155,675 | 161,388 | 142,311 | 158,735 |
| Utilities | 74,749 | 82,541 | 67,353 | 78,851 |
| | 1,702,496 | 1,874,316 | 1,733,950 | 2,010,292 |
| Emerging market pooled funds | 55,559 | 58,803 | - | - |
| Receivable from sale of investments and accrued investment income | 23,849 | 23,849 | 21,318 | 21,318 |
| Accounts payable and accrued liabilities | (20,405) | (20,405) | (19,319) | (19,319) |
| | 3,444 | 3,444 | 1,999 | 1,999 |
| | $ 1,798,907 | $ 1,973,971 | $ 1,776,500 | $ 2,052,842 |

a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

| **Public Equities by Country** | 2005 Cost | 2005 Fund's share Fair Value | 2004 Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| United Kingdom | $ 380,864 | $ 405,968 | $ 421,563 | $ 462,861 |
| Japan | 312,925 | 320,278 | 318,432 | 385,621 |
| France | 162,309 | 183,838 | 163,625 | 188,025 |
| Germany | 119,400 | 131,916 | 119,043 | 136,328 |
| Switzerland | 106,425 | 117,242 | 142,150 | 157,843 |
| Netherlands | 91,777 | 100,489 | 98,481 | 109,348 |
| Australia | 67,350 | 83,907 | 73,965 | 98,036 |
| Italy | 59,403 | 71,454 | 77,319 | 88,605 |
| Spain | 46,605 | 54,061 | 44,093 | 53,543 |
| Sweden | 44,048 | 49,991 | 30,189 | 37,619 |
| Other | 311,390 | 355,172 | 245,090 | 292,463 |
| | $ 1,702,496 | $ 1,874,316 | $ 1,733,950 | $ 2,010,292 |

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

March 31, 2005 *(thousands)*

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 469 | $ 469 | $ 1,162 | $ 1,162 |
| **Real estate (a)** | | | | |
| Office | 453,555 | 522,348 | 369,962 | 422,531 |
| Retail | 360,867 | 465,131 | 378,702 | 402,264 |
| Industrial | 79,273 | 90,736 | 57,490 | 63,298 |
| Residential | 53,785 | 51,850 | 53,909 | 49,782 |
| | 947,480 | 1,130,065 | 860,063 | 937,875 |
| Foreign Private Real Estate Pool | 43,161 | 40,948 | - | - |
| Participation units | 16,571 | 16,571 | 8,355 | 8,355 |
| Accrued income and accounts receivable | 1,521 | 1,521 | 2,379 | 2,379 |
| | $ 1,009,202 | $ 1,189,574 | $ 871,959 | $ 949,771 |

a) The following is a summary of real estate investments by geographic location:

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| Ontario | $ 606,473 | $ 752,027 | $ 635,609 | $ 693,793 |
| Alberta | 192,339 | 234,630 | 206,072 | 224,660 |
| Quebec | 126,049 | 118,870 | - | - |
| British Columbia | 22,619 | 24,538 | 18,382 | 19,422 |
| | $ 947,480 | $ 1,130,065 | $ 860,063 | $ 937,875 |

ALBERTA HERITAGE SAVINGS TRUST FUND

## SCHEDULE OF INVESTMENT RETURNS — Schedule F

Year Ended March 31, 2005

The Fund uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Investment returns for the Fund are as follows:

| Time-weighted rates of return | One Year Return 2005 | 2004 | 2003 | 2002 | 2001 | 5 Year Compound Annualized Return |
|---|---|---|---|---|---|---|
| **Short-term fixed income** | **2.3** | **2.9** | **3.0** | **3.8** | **5.7** | **3.5** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *5.7* | *3.5* |
| **Long-term fixed income** | **5.5** | **11.6** | **9.5** | **5.9** | **9.5** | **8.4** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *8.7* | *7.7* |
| **Canadian equities** | **15.4** | **36.6** | **(16.6)** | **4.2** | **(16.0)** | **2.9** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *(18.6)* | *2.0* |
| **United States equities** | **(1.6)** | **22.1** | **(30.6)** | **1.4** | **(14.4)** | **(6.3)** |
| *S&P 1500 Index* | *(1.0)* | *20.5* | *(30.7)* | *1.6* | *(15.1)* | *(6.5)* |
| **Non-North American equities** | **7.6** | **40.9** | **(29.1)** | **(5.8)** | **(22.6)** | **(4.8)** |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(19.6)* | *(4.7)* |
| **Real estate** | **17.0** | **7.5** | **9.8** | **7.3** | **9.7** | **10.2** |
| *Consumer Price Index plus 5%* | *7.1* | *5.7* | *9.6* | *9.9* | *11.9* | *8.8* |
| **Absolute return strategies** | **5.5** | **10.7** | **1.6** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 6%* | *8.1* | *6.7* | *4.7* | *n/a* | *n/a* | *n/a* |
| **Private equities** | **5.2** | **4.6** | **(3.3)** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 8%* | *10.1* | *8.7* | *5.7* | *n/a* | *n/a* | *n/a* |
| **Private income** | **5.3** | **n/a** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 6%* | *8.1* | *n/a* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Total Endowment portfolio** | **7.7** | **22.5** | **(11.3)** | **3.3** | **(6.1)** | **2.6** |
| *Policy Benchmark* | *6.4* | *21.7* | *(11.7)* | *3.4* | *(6.2)* | *2.1* |
| **Transition portfolio** | **n/a** | **n/a** | **0.5** | **5.3** | **8.2** | **n/a** |
| **Overall Return** | **7.7** | **22.5** | **(11.0)** | **4.2** | **(0.1)** | **4.1** |

# ALBERTA HERITAGE SCHOLARSHIP FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Alberta Heritage Scholarship Fund as at March 31, 2005 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
May 20, 2005

Fred J. Dunn, FCA
Auditor General

ALBERTA HERITAGE SCHOLARSHIP FUND

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 249,274 | $ 251,236 |
| Contributions receivable | 359 | 104 |
| Administration expense receivable | 9 | 14 |
| | $ 249,642 | $ 251,354 |
| **Endowment and Retained Earnings** | | |
| Endowment (Note 6) | $ 100,000 | $ 100,000 |
| Retained earnings (Note 6) | 149,642 | 151,354 |
| | $ 249,642 | $ 251,354 |

## STATEMENT OF INCOME AND RETAINED EARNINGS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Income** | | | |
| Net investment income (Note 7) | $ 8,799 | $ 20,878 | $ 22,513 |
| Contributions from Province of Alberta | 200 | 359 | 104 |
| Other contributions | 40 | 80 | 18 |
| | 9,039 | 21,317 | 22,635 |
| **Expenses** | | | |
| Scholarships | 21,380 | 23,029 | 22,264 |
| **Net income (loss)** | $ (12,341) | (1,712) | 371 |
| **Retained earnings at beginning of year** | | 151,354 | 150,983 |
| **Retained earnings at end of year** | | $ 149,642 | $ 151,354 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SCHOLARSHIP FUND

## STATEMENT OF CASH FLOWS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Operating transactions** | | |
| Net income (loss) | $ (1,712) | $ 371 |
| Non-cash items included in net income | (2,193) | (2,489) |
| | (3,905) | (2,118) |
| Decrease (increase) in receivables | (250) | 1,572 |
| Cash applied to operating transactions | (4,155) | (546) |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 73,436 | 36,230 |
| Purchase of investments | (69,681) | (38,281) |
| Cash provided by (applied to) investing transactions | 3,755 | (2,051) |
| **Decrease in cash** | (400) | (2,597) |
| **Cash at beginning of year** | 5,482 | 8,079 |
| **Cash at end of year** | $ 5,082 | $ 5,482 |
| **Consisting of Deposit in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 5,082 | $ 5,482 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SCHOLARSHIP FUND

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005 *(thousands)*

## NOTE 1 AUTHORITY AND PURPOSE

The Alberta Heritage Scholarship Fund ("the Fund") operates under the authority of the *Alberta Heritage Scholarship Act*, Chapter A 24, Revised Statutes of Alberta 2000.

The purpose of the Fund is to invest the endowment made to the Fund. The Fund is managed with the objectives of providing an annual level of income for scholarships while preserving the capital of the endowment over the long term. The portfolio is comprised of high quality fixed-income securities, equities, real estate, absolute return strategy investments and derivative financial instruments.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

**(a) Portfolio Investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

**(b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability.

Gains and losses arising as a result of disposals of investments are included in the determination of investment income.

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 2 (continued)**

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures contracts, forward foreign exchange contracts and credit default swap contracts, are recorded at fair value.

**(c) Foreign Currency**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**(d) Investment Valuation**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Measurement uncertainty exists in the fair values reported for certain investments such as private equities, private real estate, absolute return strategies and other private placements. The fair value of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 2 (continued)**

Fair value of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.
(ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
(iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analysis.
(iv) Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including replacement cost, direct comparison, direct capitalization of earnings and discounted cash flows.
(v) The fair value of absolute return strategy investments are estimated by external managers.
(vi) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.
(vii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**(e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 5, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated fair value of derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.
(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
(iv) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

ALBERTA HERITAGE SCHOLARSHIP FUND

## NOTE 3 PORTFOLIO INVESTMENTS

*(thousands)*

| | 2005 Cost | 2005 Fair Value | 2005 % | 2004 Cost | 2004 Fair Value | 2004 % |
|---|---|---|---|---|---|---|
| **Fixed-Income Securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 5,082 | $ 5,082 | 1.9 | $ 5,482 | $ 5,482 | 2.1 |
| Canadian Dollar Public Bond Pool (b) | 60,081 | 60,807 | 23.1 | 57,806 | 59,084 | 22.2 |
| Private Mortgage Pool (c ) | 9,067 | 9,838 | 3.7 | 9,390 | 10,477 | 3.9 |
| Overlay Pool (d ) | 521 | 522 | 0.2 | - | - | - |
| | 74,751 | 76,249 | 28.9 | 72,678 | 75,043 | 28.2 |
| **Canadian Equities (Schedule B)** | | | | | | |
| Domestic Passive Equity Pooled Fund (e) | 28,235 | 28,796 | 10.9 | 28,043 | 28,752 | 10.8 |
| Canadian Pooled Equity Fund (f) | 14,530 | 17,508 | 6.6 | 15,610 | 18,316 | 6.9 |
| External Managers: | | | | | | |
| Canadian Equity Enhanced Index Pool (g) | 8,581 | 9,391 | 3.6 | - | - | - |
| Canadian Large Cap Pool (h) | 5,070 | 5,601 | 2.1 | 15,194 | 17,388 | 6.5 |
| Canadian Small Cap Pool | - | - | - | 1,067 | 1,425 | 0.5 |
| Growing Equity Income Pool (i) | 4,050 | 4,814 | 1.8 | 4,532 | 4,752 | 1.8 |
| Canadian Multi-Cap Pool (j) | 3,973 | 3,976 | 1.5 | - | - | - |
| | 64,439 | 70,086 | 26.5 | 64,446 | 70,633 | 26.5 |
| Overlay Pool Canadian futures contracts (d) | (2,663) | (2,663) | (1.0) | - | - | - |
| | 61,776 | 67,423 | 25.5 | 64,446 | 70,633 | 26.5 |
| **United States Equities (Schedule C)** | | | | | | |
| S&P 500 Index Fund (k) | 33,404 | 34,440 | 13.1 | 18,727 | 20,234 | 7.6 |
| External Managers: | | | | | | |
| US Large Cap Equity Pool | 6 | 6 | - | 20,871 | 20,106 | 7.5 |
| US Small/Mid Cap Equity Pool (l) | 4,871 | 5,207 | 2.0 | 4,738 | 5,462 | 2.1 |
| Growing Equity Income Pool (i) | 772 | 767 | 0.3 | - | - | - |
| | 39,053 | 40,420 | 15.4 | 44,336 | 45,802 | 17.2 |
| Overlay Pool US futures contracts (d) | 2,677 | 2,677 | 1.0 | - | - | - |
| | 41,730 | 43,097 | 16.4 | 44,336 | 45,802 | 17.2 |
| **Non-North American Equities (Schedule D)** | | | | | | |
| External Managers: | | | | | | |
| EAFE Core Equity Pool (m) | 20,870 | 20,516 | 7.8 | 24,194 | 24,246 | 9.1 |
| EAFE Plus Equity Pool (m) | 10,368 | 10,440 | 4.0 | 12,135 | 12,841 | 4.8 |
| EAFE Passive Equity Pool (n) | 6,556 | 8,331 | 3.2 | 7,687 | 10,187 | 3.8 |
| Emerging Markets Equity Pool (o) | 2,829 | 3,122 | 1.2 | - | - | - |
| | 40,623 | 42,409 | 16.2 | 44,016 | 47,274 | 17.7 |
| **Real Estate (Schedule E)** | | | | | | |
| Private Real Estate Pool (p) | 18,618 | 22,471 | 8.5 | 16,632 | 18,452 | 6.9 |
| Foreign Private Real Estate Pool (q) | 937 | 889 | 0.3 | - | - | - |
| | 19,555 | 23,360 | 8.8 | 16,632 | 18,452 | 6.9 |
| **Absolute Return Strategies** | | | | | | |
| External Managers: | | | | | | |
| Absolute Return Strategy Pool (r) | 8,369 | 8,361 | 3.2 | 7,930 | 7,926 | 3.0 |
| **Private Equities and Income (s)** | | | | | | |
| Private Equity Pools | 1,265 | 1,443 | 0.6 | 1,198 | 1,428 | 0.5 |
| Private Income Pool | 1,205 | 1,187 | 0.4 | - | - | - |
| | 2,470 | 2,630 | 1.0 | 1,198 | 1,428 | 0.5 |
| **Total Investments (t)** | $ 249,274 | $ 263,529 | 100.0 | $ 251,236 | $ 266,558 | 100.0 |

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 3 (continued)**

The Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | % Ownership | |
|---|---|---|
| | **2005** | **2004** |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 0.7 | 0.7 |
| Canadian Multi-Cap Pool | 1.7 | – |
| Canadian Pooled Equity Fund | 1.6 | 1.8 |
| Domestic Passive Equity Pooled Fund | 1.2 | 1.2 |
| Foreign Private Equity Pool (02) | 1.0 | 1.0 |
| Foreign Private Real Estate Pool | 1.9 | – |
| Growing Equity Income Pool | 1.9 | 1.9 |
| Overlay Pool | 0.8 | – |
| Private Equity Pool | 2.2 | 2.2 |
| Private Equity Pool (02) | 0.9 | 0.9 |
| Private Income Pool | 0.5 | 0.8 |
| Private Mortgage Pool | 0.8 | 0.9 |
| Private Real Estate Pool | 0.8 | 0.8 |
| Standard & Poor's 500 Index Fund | 1.9 | 1.6 |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 1.2 | 1.4 |
| Canadian Equity Enhanced Index Pool | 1.8 | – |
| Canadian Large Cap Equity Pool | 0.2 | 0.6 |
| Canadian Small Cap Equity Pool | – | 0.2 |
| EAFE Core Equity Pool | 0.7 | 0.8 |
| EAFE Passive Equity Pool | 1.8 | 1.5 |
| EAFE Plus Equity Pool | 0.7 | 0.9 |
| Emerging Markets Pool | 0.7 | – |
| US Large Cap Equity Pool | – | 1.0 |
| US Small/Mid Cap Equity Pool | 0.6 | 0.8 |

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12 % (2004: 10%); and over 20 years: 16% (2004: 18%).

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 3 (continued)**

(c) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%); 1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% (2004: 20%); and over 20 years: 21% (2004: 24%).

(d) The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to U.S. equities.

(e) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

(f) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection, while remaining sector neutral.

(g) The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.

(h) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

(i) The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income to client portfolios by investing in mature companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well-capitalized companies. The performance of the pool is measured against the total return of a custom S&P/TSX Composite Index for dividend paying stocks.

(j) The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 3 (continued)**

(k) Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 Index. The performance objective is to provide returns comparable to the total return of the S&P 500 Index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3 (e)).

(l) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

(m) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

(n) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicate the MSCI EAFE index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.

(o) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.

(p) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

(q) The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 5.0%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.

(r) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

(s) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02, the Foreign Private Equity Pool 2002 and the Private Income Pool. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool allows unit holders to participate as equity investors in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%

(t) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and are temporary in nature.

ALBERTA HERITAGE SCHOLARSHIP FUND

## NOTE 4 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn an optimal financial return at an acceptable level of risk, management of the Fund established the following long-term policy asset mix for the 2004-2005 fiscal year:

| | |
|---|---|
| Fixed-income securities | 35% to 25% |
| Equities | 65% to 75% |

Risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 5 (continued)**

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

*(thousands)*

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Fair Value (b) | Notional Amount (a) | Fair Value (b) |
| Equity index swap contracts | 75% | 25% | - | $ 35,355 | $ 332 | $ 26,248 | $ (174) |
| Interest rate swap contracts | 38% | 49% | 13% | 13,891 | (354) | 16,057 | (715) |
| Forward foreign exchange contracts | 100% | - | - | 15,779 | 205 | 9,970 | 79 |
| Cross-currency interest rate swaps | 8% | 34% | 58% | 13,896 | 201 | 8,043 | (841) |
| Credit default swap contracts | 34% | 11% | 55% | 3,441 | 34 | 1,060 | (9) |
| Bond index swap contracts | 100% | - | - | 1,182 | 8 | 836 | 20 |
| Equity index futures contracts | 100% | - | - | 5,740 | 68 | 178 | 20 |
| | | | | $ 89,284 | $ 494 | $ 62,392 | $ (1,620) |

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in Note 2 (e).

## NOTE 6 ENDOWMENT AND RETAINED EARNINGS

The endowment was received from the Alberta Heritage Savings Trust Fund on March 31, 1980. The *Alberta Heritage Scholarship Act* provides that money required by the Students Finance Board for providing scholarships or for paying for the costs of administering scholarships, shall be paid from the Fund, but no portion of the original endowment may be paid out of the Fund.

## NOTE 7 NET INVESTMENT INCOME (LOSS)

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Deposits and fixed-income securities | $ 4,781 | $ 5,352 |
| Canadian equities | 10,466 | 10,808 |
| United States equities | (906) | 923 |
| Non-North American equities | 4,652 | 3,351 |
| Real estate | 1,364 | 1,057 |
| Absolute return strategies | 440 | 738 |
| Private equities | 157 | 349 |
| **Investment income** | $ 20,954 | $ 22,578 |
| Direct administration expense (Note 8) | (76) | (65) |
| **Net investment income** | $ 20,878 | $ 22,513 |

ALBERTA HERITAGE SCHOLARSHIP FUND

**NOTE 7 (continued)**

Investment income is comprised of interest, dividends, amortization of discount or premium, swap income, security lending income and realized gains and losses, net of write-downs on investments. The Fund's share of income earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

The investment income for the year ended March 31, 2005 includes writedowns of $628 (2004: $74).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expenses include investment management, cash management and safekeeping costs and other expenses charged on a cost-recovery basis directly by Alberta Finance. The Fund's total administrative expenses for the period, including amounts deducted directly from investment income of pooled investment funds is as follows:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Direct fund expenses | $ 76 | $ 65 |
| Externally managed investment pools | 340 | 287 |
| Internally managed investment pools | 82 | 68 |
| | $ 498 | $ 420 |
| Expenses as a percentage of net assets at fair value | 0.189% | 0.158% |

## NOTE 9 INVESTMENT PERFORMANCE

The following is a summary of the investment performance results attained by the Fund determined on a fair value basis:

| | One Year Return | Five Year Compound Annualized Return |
|---|---|---|
| **Time-weighted rates of return** | | |
| Overall actual return | 8.1% | 1.6% |
| Benchmark return* | 6.7% | 1.1% |

* The overall benchmark return for year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

ALBERTA HERITAGE SCHOLARSHIP FUND

# SCHEDULES TO THE FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

March 31, 2005 *(thousands)*

| | | Fund's share 2005 | | Fund's share 2004 |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 5,727 | $ 5,727 | $ 5,576 | $ 5,576 |
| **Fixed-income securities (a)** | | | | |
| Corporate, public and private | 35,758 | 36,327 | 38,685 | 39,925 |
| Government of Canada, direct and guaranteed | 18,229 | 18,236 | 14,001 | 14,078 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 35 | 37 | 40 | 44 |
| Other provinces | 13,780 | 14,664 | 13,703 | 14,711 |
| Municipal | 735 | 771 | 767 | 803 |
| | 68,537 | 70,035 | 67,196 | 69,561 |
| Receivable from sale of investments and accrued investment income | 837 | 837 | 743 | 743 |
| Accounts payable and accrued liabilities | (350) | (350) | (837) | (837) |
| | 487 | 487 | (94) | (94) |
| | $ 74,751 | $ 76,249 | $ 72,678 | $ 75,043 |

(a) Fixed-income securities held as at March 31, 2005 have an average effective market yield of 4.59% per annum (2004: 4.39% per annum) and the following term structure based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| Under 1 year | 3 | 3 |
| 1 to 5 years | 35 | 37 |
| 5 to 10 years | 33 | 30 |
| 10 to 20 years | 12 | 11 |
| Over 20 years | 17 | 19 |
| | 100 | 100 |

ALBERTA HERITAGE SCHOLARSHIP FUND

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

March 31, 2005 *(thousands)*

| | 2005 Fund's share Cost | 2005 Fund's share Fair Value | 2004 Fund's share Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 510 | $ 510 | $ 506 | $ 506 |
| **Public equities (a)(b)** | | | | |
| Consumer discretionary | 4,410 | 4,255 | 5,208 | 5,014 |
| Consumer staples | 2,591 | 2,914 | 2,571 | 2,832 |
| Energy | 11,197 | 13,726 | 8,568 | 10,322 |
| Financials | 19,835 | 21,659 | 20,297 | 22,962 |
| Health Care | 1,057 | 895 | 1,517 | 1,455 |
| Industrials | 3,226 | 3,623 | 5,117 | 5,373 |
| Information technology | 3,753 | 3,611 | 4,549 | 5,220 |
| Materials | 8,912 | 9,580 | 10,598 | 11,527 |
| Telecommunication services | 3,886 | 4,151 | 3,549 | 3,342 |
| Utilities | 846 | 931 | 2,437 | 2,552 |
| | 59,713 | 65,345 | 64,411 | 70,599 |
| Small Cap Equity Pool | 1,195 | 1,210 | 18 | 17 |
| Receivable from sale of investments and accrued investment income | 1,094 | 1,094 | 276 | 276 |
| Accounts payable and accrued liabilities | (736) | (736) | (765) | (765) |
| | 358 | 358 | (489) | (489) |
| | $ 61,776 | $ 67,423 | $ 64,446 | $ 70,633 |

(a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $25,376 (2004: $20,198).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

ALBERTA HERITAGE SCHOLARSHIP FUND

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

March 31, 2005 *(thousands)*

| | 2005 Cost | 2005 Fund's share Fair Value | 2004 Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 287 | $ 287 | $ 712 | $ 712 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 4,754 | 5,034 | 7,446 | 7,627 |
| Consumer staples | 3,952 | 3,971 | 4,246 | 4,216 |
| Energy | 3,240 | 3,682 | 2,601 | 2,625 |
| Financials | 8,705 | 8,747 | 8,622 | 9,269 |
| Health Care | 5,511 | 5,494 | 5,756 | 5,467 |
| Industrials | 5,106 | 5,387 | 4,954 | 5,191 |
| Information technology | 6,323 | 6,422 | 6,708 | 7,163 |
| Materials | 1,548 | 1,679 | 1,460 | 1,720 |
| Telecommunication services | 1,181 | 1,162 | 1,318 | 1,255 |
| Utilities | 1,445 | 1,554 | 993 | 1,037 |
| | 41,765 | 43,132 | 44,104 | 45,570 |
| Receivable from sale of investments and accrued investment income | 181 | 181 | 178 | 178 |
| Accounts payable and accrued liabilities | (503) | (503) | (658) | (658) |
| | (322) | (322) | (480) | (480) |
| | $ 41,730 | $ 43,097 | $ 44,336 | $ 45,802 |

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling $15,719 (2004: $6,228).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

ALBERTA HERITAGE SCHOLARSHIP FUND

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

March 31, 2005 *(thousands)*

| | Fund's share 2005 | | Fund's share 2004 | |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 796 | $ 796 | $ 986 | $ 986 |
| **Public equities (a)** | | | | |
| Consumer discretionary | 5,374 | 5,429 | 6,641 | 7,268 |
| Consumer staples | 2,310 | 2,357 | 3,333 | 3,440 |
| Energy | 3,261 | 3,557 | 3,452 | 3,531 |
| Financials | 9,945 | 10,746 | 10,031 | 11,126 |
| Health Care | 2,552 | 2,445 | 3,707 | 3,567 |
| Industrials | 4,528 | 4,863 | 4,938 | 5,380 |
| Information technology | 2,079 | 2,041 | 2,430 | 2,865 |
| Materials | 3,260 | 3,575 | 3,293 | 3,658 |
| Telecommunication services | 3,525 | 3,451 | 3,527 | 3,629 |
| Utilities | 1,697 | 1,778 | 1,644 | 1,790 |
| | 38,531 | 40,242 | 42,996 | 46,254 |
| Emerging markets pooled funds | 1,222 | 1,297 | - | - |
| Receivable from sale of investments and accrued investment income | 508 | 508 | 520 | 520 |
| Accounts payable and accrued liabilities | (434) | (434) | (486) | (486) |
| | 74 | 74 | 34 | 34 |
| | $ 40,623 | $ 42,409 | $ 44,016 | $ 47,274 |

(a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

| | Fund's share 2005 | | Fund's share 2004 | |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| United Kingdom | $ 8,658 | $ 8,738 | $ 10,398 | $ 10,587 |
| Japan | 7,105 | 6,897 | 7,838 | 8,814 |
| France | 3,677 | 3,935 | 4,050 | 4,319 |
| Germany | 2,699 | 2,826 | 2,967 | 3,159 |
| Switzerland | 2,413 | 2,517 | 3,535 | 3,646 |
| Netherlands | 2,088 | 2,150 | 2,429 | 2,498 |
| Australia | 1,527 | 1,801 | 1,832 | 2,230 |
| Italy | 1,347 | 1,534 | 1,921 | 2,044 |
| Spain | 1,064 | 1,164 | 1,076 | 1,201 |
| Sweden | 992 | 1,071 | 747 | 840 |
| Other | 6,961 | 7,609 | 6,203 | 6,916 |
| | $ 38,531 | $ 40,242 | $ 42,996 | $ 46,254 |

ALBERTA HERITAGE SCHOLARSHIP FUND

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

March 31, 2005 *(thousands)*

| | 2005 Fund's share Cost | 2005 Fund's share Fair Value | 2004 Fund's share Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 9 | $ 9 | $ 23 | $ 23 |
| **Real estate (a)** | | | | |
| Office | 8,739 | 10,218 | 7,055 | 8,209 |
| Retail | 6,953 | 9,100 | 7,222 | 7,815 |
| Industrial | 1,527 | 1,775 | 1,096 | 1,230 |
| Residential | 1,036 | 1,014 | 1,028 | 967 |
| | 18,255 | 22,107 | 16,401 | 18,221 |
| Foreign Private Equity Pool | 937 | 890 | - | - |
| Participation units | 324 | 324 | 162 | 162 |
| **Accrued income and accounts receivable** | 30 | 30 | 46 | 46 |
| | $ 19,555 | $ 23,360 | $ 16,632 | $ 18,452 |

a) The following is a summary of real estate investments by geographic location:

| | 2005 Fund's share Cost | 2005 Fund's share Fair Value | 2004 Fund's share Cost | 2004 Fund's share Fair Value |
|---|---|---|---|---|
| Ontario | $ 11,684 | $ 14,712 | $ 12,121 | $ 13,479 |
| Alberta | 3,706 | 4,590 | 3,930 | 4,365 |
| Quebec | 2,429 | 2,325 | - | - |
| British Columbia | 436 | 480 | 350 | 377 |
| | $ 18,255 | $ 22,107 | $ 16,401 | $ 18,221 |

ALBERTA HERITAGE SCHOLARSHIP FUND

## SCHEDULE OF INVESTMENT RETURNS — Schedule F

Year Ended March 31, 2005

The Fund uses a time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

| | One Year Return | | | | | 5 Year Compound Annualized |
|---|---|---|---|---|---|---|
| **Time-weighted Rates of Return** | **2005** | **2004** | **2003** | **2002** | **2001** | **Return** |
| **Short-term fixed income** | **2.7** | **3.0** | **2.9** | **4.1** | **6.0** | **3.7** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *5.7* | *3.5* |
| **Long-term fixed income** | **5.6** | **11.6** | **9.7** | **5.9** | **9.4** | **8.4** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *8.7* | *7.7* |
| **Canadian equities** | **15.4** | **36.2** | **(17.4)** | **3.4** | **(16.0)** | **2.4** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *(18.6)* | *2.0* |
| **United States equities** | **(2.0)** | **22.2** | **(30.6)** | **1.4** | **(14.3)** | **(6.3)** |
| *S&P 500 Index* | *(1.0)* | *20.5* | *(30.7)* | *1.6* | *(15.1)* | *(6.5)* |
| **Non-North American equities** | **7.5** | **40.9** | **(29.1)** | **(5.9)** | **(23.1)** | **(4.9)** |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(19.6)* | *(4.7)* |
| **Real estate** | **16.7** | **7.5** | **9.8** | **7.2** | **9.7** | **10.1** |
| *Consumer Price Index (CPI) plus 5%* | *7.1* | *5.7* | *8.9* | *9.9* | *11.9* | *8.7* |
| **Absolute return strategies** | **5.5** | **10.7** | **1.6** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *6.7* | *4.7* | *n/a* | *n/a* | *n/a* |
| **Private equities** | **(1.1)** | **1.3** | **(3.5)** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 8%* | *10.1* | *8.7* | *5.7* | *n/a* | *n/a* | *n/a* |
| **Private income** | **5.3** | **n/a** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *n/a* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Overall** | **8.1** | **24.0** | **(13.3)** | **2.3** | **(8.9)** | **1.6** |
| ***Policy Benchmark*** | ***6.7*** | ***23.4*** | ***(13.7)*** | ***2.7*** | ***(9.5)*** | ***1.1*** |

# ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Alberta Heritage Science and Engineering Research Endowment Fund as at March 31, 2005 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 538,344 | $ 521,616 |
| Administration expense receivable | 15 | 14 |
| | $ 538,359 | $ 521,630 |
| **Liabilities, Endowment and Retained Earnings** | | |
| Accounts payable | $ 940 | $ - |
| Endowment (Note 6) | 500,000 | 500,000 |
| Retained earnings (Note 6) | 37,419 | 21,630 |
| | $ 538,359 | $ 521,630 |

## STATEMENT OF INCOME AND RETAINED EARNINGS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 Budget | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Income** | | | |
| Net investment income (Note 7) | $ 11,840 | $ 29,234 | $ 37,106 |
| Transfer from the General Revenue Fund | - | - | 21,430 |
| | 11,840 | 29,234 | 58,536 |
| **Expenses** | | | |
| Transfers to the Alberta Heritage Foundation for Science and Engineering Research (Note 6) | 17,217 | 13,445 | 10,416 |
| **Net income (loss)** | $ (5,377) | 15,789 | 48,120 |
| **Retained earnings (deficit) at beginning of year** | | 21,630 | (26,490) |
| **Retained earnings at end of year** | | $ 37,419 | $ 21,630 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## STATEMENT OF CASH FLOWS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Operating transactions** | | |
| Net income | $ 15,789 | $ 48,120 |
| Non-cash items included in net income | 4,413 | 1,363 |
| | 20,202 | 49,483 |
| Decrease (increase) in receivables | (1) | 305 |
| Increase (decrease) in payables | 940 | (1) |
| Cash provided by operating transactions | 21,141 | 49,787 |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 136,169 | 40,506 |
| Purchase of investments | (151,461) | (100,271) |
| Cash applied to investing transactions | (15,292) | (59,765) |
| **Increase (decrease) in cash** | 5,849 | (9,978) |
| **Cash at beginning of year** | 4,412 | 14,390 |
| **Cash at end of year** | $ 10,261 | $ 4,412 |
| **Consisting of Deposit in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 10,261 | $ 4,412 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

# NOTES TO THE FINANCIAL STATEMENTS

Year Ended March 31, 2005

## NOTE 1 AUTHORITY AND PURPOSE

The Alberta Heritage Science and Engineering Research Endowment Fund ("the Fund") operates under the authority of the *Alberta Heritage Foundation for Science and Engineering Research Act*, Chapter A-22, Revised Statutes of Alberta 2000.

The purpose of the Fund is to invest the endowment made to the Fund. The Fund has been managed with the objectives of providing an annual level of income for transfer to the Alberta Heritage Foundation for Science and Engineering while preserving the capital of the endowment over the long term. The portfolio is comprised of high quality fixed-income securities, equities, real estate, absolute return strategy investments and derivative financial instruments.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

**(a) Portfolio Investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 2 (continued)**

**b) Income Recognition**

Investment income is recorded on the accrual basis. Gains and losses arising as a result of disposals are included in the determination of investment income.

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps and equity index futures contracts, forward foreign exchange contracts and credit default swap contracts, are recorded at fair value.

**c) Foreign Currency**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**d) Investment Valuation**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Measurement uncertainty exists in the fair values reported for certain investments such as private equities, private real estate, absolute return strategies and other private placements. The fair value of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 2 (continued)**

Fair values of investments held either by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.
(ii) Private fixed-income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by management.
(iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analyses.
(iv) The fair value of real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including replacement cost, direct comparison, direct capitalization of earnings and discounted cash flows.
(v) The fair value of absolute return strategy investments is estimated by external managers.
(vi) The fair values of deposits, receivables, accrued interest and payables are estimated to approximate their book values.
(vii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 5, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated fair value of derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.
(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
(iv) Forward foreign exchange contracts and equity index futures contracts are valued based on quoted market prices.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## NOTE 3 PORTFOLIO INVESTMENTS (Schedules A to E)

*(thousands)*

| | 2005 Cost | 2005 Fair Value | 2005 % | 2004 Cost | 2004 Fair Value | 2004 % |
|---|---|---|---|---|---|---|
| **Fixed-Income Securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 10,261 | $ 10,261 | 1.9 | $ 4,412 | $ 4,412 | 0.8 |
| Canadian Dollar Public Bond Pool (b) | 140,906 | 145,692 | 26.5 | 150,432 | 157,029 | 29.8 |
| Private Mortgage Pool (c ) | 24,005 | 25,016 | 4.6 | 25,285 | 26,384 | 5.0 |
| Overlay Pool (d) | 1,090 | 1,092 | 0.2 | - | - | - |
| | 176,262 | 182,061 | 33.2 | 180,129 | 187,825 | 35.6 |
| **Canadian Equities (Schedule B)** | | | | | | |
| Domestic Passive Equity Pooled Fund (e) | 36,838 | 34,494 | 6.3 | 54,518 | 50,606 | 9.6 |
| Canadian Pooled Equity Fund (f) | 24,136 | 22,306 | 4.1 | 35,481 | 31,003 | 5.9 |
| External Managers: | | | | | | |
| Canadian Equity Enhanced Index Pool (g) | 10,628 | 11,631 | 2.1 | - | - | - |
| Canadian Large Cap Pool (h) | 7,521 | 7,055 | 1.3 | 33,853 | 32,000 | 6.1 |
| Canadian Small Cap Pool | - | - | - | 1,389 | 1,687 | 0.3 |
| Growing Equity Income Pool (i) | 5,673 | 6,744 | 1.2 | 7,856 | 8,237 | 1.5 |
| Canadian Multi-Cap Pool (j) | 4,921 | 4,925 | 0.9 | - | - | - |
| | 89,717 | 87,155 | 15.9 | 133,097 | 123,533 | 23.4 |
| Overlay Pool Canadian futures contracts (d) | (5,569) | (5,569) | (1.0) | - | - | - |
| | 84,148 | 81,586 | 14.9 | 133,097 | 123,533 | 23.4 |
| **United States Equities (Schedule C)** | | | | | | |
| S&P 500 Index Fund (k) | 65,728 | 67,771 | 12.3 | 41,035 | 43,624 | 8.3 |
| External Managers: | | | | | | |
| US Large Cap Equity Pool | 5 | 5 | - | 27,378 | 25,223 | 4.8 |
| US Small/Mid Cap Equity Pool (l) | 12,084 | 12,116 | 2.2 | 8,849 | 9,682 | 1.8 |
| Portable Alpha United States Equity Pool (m) | 15,794 | 15,407 | 2.8 | - | - | - |
| Growing Equity Income Pool (i) | 1,082 | 1,074 | 0.2 | - | - | - |
| | 94,693 | 96,373 | 17.5 | 77,262 | 78,529 | 14.9 |
| Overlay Pool US futures contracts (d) | 5,598 | 5,598 | 1.0 | - | - | - |
| | 100,291 | 101,971 | 18.5 | 77,262 | 78,529 | 14.9 |
| **Non-North American Equities (Schedule D)** | | | | | | |
| External Managers: | | | | | | |
| EAFE Core Equity Pool (n) | 55,793 | 53,725 | 9.8 | 42,680 | 41,792 | 7.9 |
| EAFE Plus Equity Pool (n) | 28,052 | 27,837 | 5.1 | 18,356 | 19,445 | 3.7 |
| EAFE Passive Equity Pool (o) | 17,715 | 20,548 | 3.7 | 18,412 | 23,048 | 4.4 |
| Emerging Market Equity Pool (p) | 5,657 | 6,233 | 1.1 | - | - | - |
| | 107,217 | 108,343 | 19.7 | 79,448 | 84,285 | 16.0 |
| **Real Estate (Schedule E)** | | | | | | |
| Private Real Estate Pool (q) | 37,158 | 42,691 | 7.8 | 28,167 | 29,976 | 5.7 |
| Foreign Private Real Estate Pool (r) | 1,853 | 1,758 | 0.3 | - | - | - |
| | 39,011 | 44,449 | 8.1 | 28,167 | 29,976 | 5.7 |
| **Absolute Return Strategies** | | | | | | |
| External Managers: | | | | | | |
| Absolute Return Strategy Pool (s) | 26,015 | 25,817 | 4.7 | 21,625 | 21,432 | 4.1 |
| **Private Equity and Income (t)** | | | | | | |
| Private Equity Pools | 2,869 | 2,708 | 0.5 | 1,360 | 1,177 | 0.2 |
| Private Income Pools | 2,531 | 2,493 | 0.4 | 528 | 527 | 0.1 |
| | 5,400 | 5,201 | 0.9 | 1,888 | 1,704 | 0.3 |
| **Total Investments (u)** | $538,344 | $549,428 | 100.0 | $521,616 | $527,284 | 100.0 |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

The Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | % Ownership | |
|---|---|---|
| | **2005** | **2004** |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 1.6 | 1.9 |
| Canadian Multi-Cap Pool | 2.1 | - |
| Canadian Pooled Equity Fund | 2.1 | 3.0 |
| Domestic Passive Equity Pooled Fund | 1.5 | 2.2 |
| Foreign Private Equity Pool (02) | 1.7 | 1.8 |
| Foreign Private Real Estate Pool | 3.7 | - |
| Growing Equity Income Pool | 2.6 | 3.2 |
| Overlay Pool | 1.6 | - |
| Private Equity Pool (02) | 1.8 | 1.8 |
| Private Equity Pool (04) | 4.0 | - |
| Private Income Pool | 1.1 | 1.5 |
| Private Mortgage Pool | 2.1 | 2.2 |
| Private Real Estate Pool | 1.5 | 1.4 |
| Standard & Poor's 500 Index Fund | 3.7 | 3.5 |
| Portable Alpha United States Equity Pool | 4.3 | - |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 3.7 | 3.7 |
| Canadian Equity Enhanced Index Pool | 2.2 | - |
| Canadian Large Cap Equity Pool | 0.3 | 1.0 |
| Canadian Small Cap Equity Pool | - | 0.3 |
| EAFE Core Equity Pool | 1.7 | 1.4 |
| EAFE Passive Equity Pool | 4.5 | 3.4 |
| EAFE Plus Equity Pool | 1.8 | 1.3 |
| Emerging Markets Equity Pool | 1.5 | - |
| US Large Cap Equity Pool | - | 1.3 |
| US Small/Mid Cap Equity Pool | 1.3 | 1.4 |

**(a)** The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

**(b)** The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12% (2004: 10%); and over 20 years: 16% (2004: 18%).

**(c)** The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%); 1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% ( 2004: 20%); and over 20 years: 21% (2004: 24%).

**(d)** The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to U.S. equities.

**(e)** The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

**(f)** The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection, while remaining sector neutral.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

**(g)** The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.

**(h)** The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

**(i)** The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income to client portfolios by investing in mature companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well-capitalized companies. The performance of the pool is measured against the total return of the S&P/TSX Composite Index.

**(j)** The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.

**(k)** Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 index. The performance objective is to provide returns comparable to the total return of the S&P 500 index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3(e)).

**(l)** The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

**(m)** The Portable Alpha United States Equity Pool consists of futures and swap contracts which provide exposure to the U.S. equity market by replicating the S&P 500 Index and investments in value added absolute return strategies. The performance objective is to provide returns higher than the total return of the Standard & Poor's (S&P) 500 Index over a four-year period.

**(n)** The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 3 (continued)**

**(o)** The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicate the MSCI EAFE index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.

**(p)** The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.

**(q)** The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies, which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

**(r)** The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5.0%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.

**(s)** The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6.0%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

**(t)** Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the PEP02, PEP04, the Foreign Private Equity Pool 2002 and the Private Income Pool. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool allows unit holders to participate as equity investors in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%.

**(u)** Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short term market trends and are temporary in nature.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## NOTE 4 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn an optimal financial return at an acceptable level of risk, management of the Fund established the following long-term policy asset mix for the 2004-2005 fiscal year:

| | |
|---|---|
| Fixed-income securities | 30% to 20% |
| Equities | 70% to 80% |

Risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

**NOTE 5 (continued)**

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

*(thousands)*

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Fair Value (b) | Notional Amount (a) | Fair Value (b) |
| Equity index swap contracts | 63% | 37% | - | $ 65,884 | $ 89 | $ 48,600 | $ (352) |
| Forward foreign exchange contracts | 100% | - | - | 41,166 | 567 | 24,687 | 202 |
| Interest rate swap contracts | 38% | 49% | 13% | 20,154 | (499) | 29,818 | (1,330) |
| Cross-currency interest rate swaps | 8% | 29% | 63% | 26,140 | 37 | 18,642 | (2,240) |
| Credit default swap contracts | 30% | 10% | 60% | 5,502 | 64 | 2,176 | (17) |
| Bond index swap contracts | 100% | - | - | 2,832 | 20 | 2,222 | 54 |
| Equity index futures contracts | 100% | - | - | 13,701 | 287 | 378 | 41 |
| | | | | $ 175,379 | $ 565 | $ 126,523 | $ (3,642) |

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in Note 2 (e).

## NOTE 6 ENDOWMENT AND RETAINED EARNINGS

The endowment was received from the General Revenue Fund during the fiscal year ended March 31, 2001. The Minister of Finance must, at the request of the Foundation, pay from the Endowment Fund to the Foundation money that, in the opinion of the trustees, is required by the Foundation for the furtherance of its objectives. Section 8 of the *Alberta Heritage Foundation for Science and Engineering Research Act* ("the Act") limits annual payments from the Fund to the Foundation for 2004-2005 and subsequent fiscal years. Payments to the Foundation may not exceed in a fiscal year 4.5% of the average of the market values determined on March 31 of the preceding three fiscal years and any unused portion of the amount permitted to be paid in that fiscal year may be paid in any subsequent fiscal year.

*(thousands)*

| | 2005 |
|---|---|
| Accumulated unused spending limit, at March 31, 2004 | $ - |
| 4.5% of average market value on March 31, 2002-04 | 21,347 |
| Spending limit for the year ended March 31, 2005 | 21,347 |
| Transfers to Foundation during the year | (13,445) |
| Accumulated unused spending limit at March 31, 2005 | 7,902 |
| 4.5% of average market value on March 31, 2003-05 | 22,444 |
| Spending limit for the year ended March 31, 2006 | $ 30,346 |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## NOTE 7 NET INVESTMENT INCOME (LOSS)

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Deposits and fixed-income securities | $ 11,445 | $ 13,164 |
| Canadian equities | 5,607 | 14,583 |
| United States equities | (2,481) | 1,189 |
| Non-North American equities | 10,863 | 4,847 |
| Real estate | 2,428 | 1,708 |
| Absolute return strategies | 1,357 | 1,535 |
| Private Equities and income | 132 | 185 |
| **Investment income** | $ 29,351 | $ 37,211 |
| Direct administration expense (Note 8) | (117) | (105) |
| **Net investment income** | $ 29,234 | $ 37,106 |

Investment income is comprised of interest, dividends, amortization of discount or premium, swap income, security lending income and realized gains and losses, net of write-downs on investments. The Fund's share of income earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

The investment income for the year ended March 31, 2005 includes writedowns of $985 (2004: $100).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expenses include investment management, cash management and safekeeping costs and other expenses charged on a cost-recovery basis directly by Alberta Finance. The Fund's total administrative expenses for the period, including amounts deducted directly from investment income of pooled investment funds is as follows:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Direct fund expenses (Note 7) | $ 117 | $ 105 |
| Externally managed investment pools | 719 | 467 |
| Internally managed investment pools | 146 | 131 |
| | $ 982 | $ 703 |
| Expenses as a percentage of net assets at fair value | 0.179% | 0.133% |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## NOTE 9 INVESTMENT PERFORMANCE

The following is a summary of the investment performance results attained by the Fund determined on a fair value basis:

| | One Year Return | Four Year Compound Annualized Return |
|---|---|---|
| **Time-weighted rates of return** | | |
| Overall actual return | 6.7% | 4.8% |
| Benchmark return* | 5.4% | 4.3% |

* The overall benchmark return for year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

# SCHEDULES TO THE FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

March 31, 2005 *(thousands)*

| | Fund's share 2005 | | Fund's share 2004 | |
|---|---|---|---|---|
| | **Cost** | **Fair Value** | **Cost** | **Fair Value** |
| **Deposits and short-term securities** | $ 11,724 | $ 11,724 | $ 4,660 | $ 4,660 |
| **Fixed income securities (a)** | | | | |
| Corporate, public and private | 86,418 | 88,398 | 101,474 | 104,746 |
| Government of Canada, direct and guaranteed | 42,676 | 43,615 | 36,435 | 37,416 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 81 | 89 | 104 | 116 |
| Other provinces | 32,464 | 35,213 | 35,718 | 39,011 |
| Municipal | 1,724 | 1,847 | 1,995 | 2,133 |
| | 163,363 | 169,162 | 175,726 | 183,422 |
| Receivable from sale of investments and accrued investment income | 2,022 | 2,022 | 1,967 | 1,967 |
| Accounts payable and accrued liabilities | (847) | (847) | (2,224) | (2,224) |
| | 1,175 | 1,175 | (257) | (257) |
| | $ 176,262 | $ 182,061 | $ 180,129 | $ 187,825 |

a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.59% per annum (2004: 4.39% per annum) and the following term structure based on principal amount:

| | **2005** % | **2004** % |
|---|---|---|
| under 1 year | 3 | 3 |
| 1 to 5 years | 35 | 37 |
| 5 to 10 years | 33 | 30 |
| 10 to 20 years | 12 | 11 |
| over 20 years | 17 | 19 |
| | 100 | 100 |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES — Schedule B

March 31, 2005 *(thousands)*

| | 2005 Cost | Fund's share 2005 Fair Value | 2004 Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 661 | $ 661 | $ 878 | $ 878 |
| **Public equities (a )(b)** | | | | |
| Consumer discretionary | 6,317 | 5,182 | 11,002 | 8,708 |
| Consumer staples | 3,629 | 3,557 | 5,413 | 4,906 |
| Energy | 14,821 | 16,579 | 17,460 | 18,060 |
| Financials | 26,710 | 26,177 | 40,963 | 40,320 |
| Health Care | 1,592 | 1,087 | 3,330 | 2,525 |
| Industrials | 4,503 | 4,403 | 10,725 | 9,326 |
| Information technology | 5,179 | 4,308 | 9,630 | 9,136 |
| Materials | 12,291 | 11,539 | 22,353 | 20,224 |
| Telecommunication services | 5,317 | 5,039 | 7,310 | 5,863 |
| Utilities | 1,240 | 1,148 | 4,878 | 4,436 |
| | 81,599 | 79,019 | 133,064 | 123,504 |
| Small Cap Pooled Fund | 1,480 | 1,498 | 24 | 20 |
| Receivable from sale of investments and accrued investment income | 1,358 | 1,358 | 483 | 483 |
| Accounts payable and accrued liabilities | (950) | (950) | (1,352) | (1,352) |
| | 408 | 408 | (869) | (869) |
| | $ 84,148 | $ 81,586 | $ 133,097 | $ 123,533 |

a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $32,887 (2004: $35,551)

b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

March 31, 2005 *(thousands)*

| | Fund's share 2005 Cost | Fund's share 2005 Fair Value | Fund's share 2004 Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 1,488 | $ 1,488 | $ 1,170 | $ 1,170 |
| **Public equities (a) (b)** | | | | |
| Consumer discretionary | 11,558 | 11,983 | 12,108 | 12,225 |
| Consumer staples | 9,498 | 9,483 | 7,522 | 7,424 |
| Energy | 7,994 | 8,800 | 4,581 | 4,531 |
| Financials | 20,429 | 20,311 | 15,193 | 16,067 |
| Health care | 13,250 | 13,105 | 10,255 | 9,604 |
| Industrials | 12,293 | 12,696 | 8,635 | 8,809 |
| Information technology | 15,283 | 15,297 | 11,970 | 12,625 |
| Materials | 3,796 | 3,987 | 2,483 | 2,798 |
| Telecommunication services | 2,831 | 2,780 | 2,377 | 2,262 |
| Utilities | 3,433 | 3,603 | 1,865 | 1,911 |
| | 100,365 | 102,045 | 76,989 | 78,256 |
| Receivable from sale of investments and accrued investment income | 813 | 813 | 291 | 291 |
| Accounts payable and accrued liabilities | (2,375) | (2,375) | (1,188) | (1,188) |
| | (1,562) | (1,562) | (897) | (897) |
| | $ 100,291 | $ 101,971 | $ 77,262 | $ 78,529 |

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling $46,698 (2004: $13,427).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's( S&P) 500 Index.

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

March 31, 2005 *(thousands)*

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 2,062 | $ 2,062 | $ 1,624 | $ 1,624 |
| **Public equities (a)** | | | | |
| Consumer discretionary | 14,285 | 13,947 | 11,902 | 12,876 |
| Consumer staples | 6,195 | 6,090 | 6,103 | 6,194 |
| Energy | 8,668 | 9,139 | 6,344 | 6,339 |
| Financials | 26,347 | 27,513 | 18,111 | 19,909 |
| Health care | 6,857 | 6,320 | 6,834 | 6,453 |
| Industrials | 12,112 | 12,599 | 8,798 | 9,497 |
| Information technology | 5,577 | 5,286 | 4,387 | 5,159 |
| Materials | 8,612 | 9,173 | 5,739 | 6,343 |
| Telecommunication services | 9,368 | 8,886 | 6,456 | 6,541 |
| Utilities | 4,505 | 4,553 | 3,058 | 3,258 |
| | 102,526 | 103,506 | 77,732 | 82,569 |
| Emerging markets pooled funds | 2,445 | 2,591 | - | - |
| Receivable from sale of investments and accrued investment income | 1,317 | 1,317 | 851 | 851 |
| Accounts payable and accrued liabilities | (1,133) | (1,133) | (759) | (759) |
| | 184 | 184 | 92 | 92 |
| | $ 107,217 | $ 108,343 | $ 79,448 | $ 84,285 |

a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

| | Cost | Fund's share 2005 Fair Value | Cost | Fund's share 2004 Fair Value |
|---|---|---|---|---|
| United Kingdom | $ 23,003 | $ 22,372 | $ 19,004 | $ 19,061 |
| Japan | 19,118 | 17,891 | 14,269 | 15,879 |
| France | 9,881 | 10,234 | 7,367 | 7,730 |
| Germany | 7,249 | 7,350 | 5,282 | 5,580 |
| Switzerland | 6,483 | 6,534 | 6,371 | 6,472 |
| Netherlands | 5,606 | 5,580 | 4,487 | 4,508 |
| Australia | 4,101 | 4,660 | 3,346 | 4,048 |
| Italy | 3,622 | 3,984 | 3,478 | 3,637 |
| Spain | 2,856 | 3,006 | 2,015 | 2,224 |
| Sweden | 2,644 | 2,762 | 1,383 | 1,567 |
| Other | 17,963 | 19,133 | 10,730 | 11,863 |
| | $ 102,526 | $ 103,506 | $ 77,732 | $ 82,569 |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

March 31, 2005 *(thousands)*

| | | 2005 Fund's share | | 2004 Fund's share |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 17 | $ 17 | $ 37 | $ 37 |
| **Real estate (a)** | | | | |
| Office | 17,457 | 19,415 | 11,955 | 13,335 |
| Retail | 13,890 | 17,287 | 12,237 | 12,696 |
| Industrial | 3,051 | 3,372 | 1,857 | 1,998 |
| Residential | 2,070 | 1,927 | 1,742 | 1,571 |
| | 36,468 | 42,001 | 27,791 | 29,600 |
| Foreign Private Equity Pool | 1,853 | 1,758 | - | - |
| Participation units | 616 | 616 | 264 | 264 |
| **Accrued income and accounts receivable** | 57 | 57 | 75 | 75 |
| | $ 39,011 | $ 44,449 | $ 28,167 | $ 29,976 |

a) The following is a summary of real estate investments by geographic location:

| | | 2005 Fund's share | | 2004 Fund's share |
|---|---|---|---|---|
| | Cost | Fair Value | Cost | Fair Value |
| Ontario | $ 23,342 | $ 27,951 | $ 20,538 | $ 21,897 |
| Alberta | 7,403 | 8,720 | 6,659 | 7,090 |
| Quebec | 4,852 | 4,418 | - | - |
| British Columbia | 871 | 912 | 594 | 613 |
| | $ 36,468 | $ 42,001 | $ 27,791 | $ 29,600 |

ALBERTA HERITAGE SCIENCE AND ENGINEERING RESEARCH ENDOWMENT FUND

## SCHEDULE OF INVESTMENT RETURNS — Schedule F

Year Ended March 31, 2005

The Fund uses a time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Investment returns for the Fund are as follows:

| Time-weighted Rates of Return | One Year Return 2005 | 2004 | 2003 | 2002 | Four Year Compound Annualized Return |
|---|---|---|---|---|---|
| **Short-term fixed Income** | **2.7** | **3.0** | **2.9** | **4.0** | **3.2** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *2.9* |
| **Long-term fixed income** | **5.6** | **11.6** | **9.6** | **5.9** | **8.1** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *7.5* |
| **Canadian equities** | **15.5** | **36.6** | **(17.1)** | **4.2** | **8.0** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *7.9* |
| **United States equities** | **(1.7)** | **22.1** | **(30.4)** | **1.4** | **(4.1)** |
| *S&P 1500 Index* | *(1.0)* | *20.5* | *(30.7)* | *1.6* | *(4.3)* |
| **Non-North American equities** | **7.4** | **40.9** | **(29.1)** | **(5.6)** | **0.3** |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(0.6)* |
| **Real estate** | **16.9** | **7.5** | **9.8** | **7.3** | **10.3** |
| *Consumer Price Index (CPI) plus 5%* | *7.1* | *5.7* | *8.9* | *9.9* | *7.9* |
| **Absolute return strategies** | **5.5** | **10.7** | **1.6** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *6.7* | *4.7* | *n/a* | *n/a* |
| **Private equities** | **0.6** | **1.2** | **(4.3)** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 8%* | *10.1* | *8.7* | *5.7* | *n/a* | *n/a* |
| **Private income** | **5.4** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index (CPI) plus 6%* | *8.1* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Overall** | **6.7** | **22.5** | **(10.2)** | **3.0** | **4.8** |
| ***Policy Benchmark*** | ***5.4*** | ***21.7*** | ***(10.6)*** | ***3.1*** | ***4.3*** |

# ALBERTA RISK MANAGEMENT FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Alberta Risk Management Fund as at March 31, 2005 and the statement of operations for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

ALBERTA RISK MANAGEMENT FUND

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents (Note 3) | $ 19,970 | $ 19,248 |
| Receivable from Province of Alberta | 52 | 33 |
| Accrued recoveries (Note 4) | 390 | 209 |
| | $ 20,412 | $ 19,490 |
| **LIABILITIES AND NET LIABILITIES** | | |
| Liabilities | | |
| Accounts payable (Note 5) | $ 529 | $ 426 |
| Liability for accrued claims (Note 6) | 25,729 | 25,255 |
| | 26,258 | 25,681 |
| Net liabilities | (5,846) | (6,191) |
| | $ 20,412 | $ 19,490 |

*The accompanying notes are part of these financial statements.*

ALBERTA RISK MANAGEMENT FUND

## STATEMENT OF OPERATIONS
For the Year Ended March 31, 2005 *(thousands)*

| | Budget | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Revenues** | | | |
| Insurance services | | | |
| Province of Alberta | | | |
| departments, funds | | | |
| and agencies | $ 7,300 | $ 7,243 | $ 6,284 |
| Other entities | 850 | 419 | 342 |
| Subrogation and salvage | 250 | 348 | 220 |
| Interest | 650 | 522 | 600 |
| | 9,050 | 8,532 | 7,446 |
| **Expenses** | | | |
| Insurance claims | 4,500 | 4,089 | 13,516 |
| Insurance premiums | 3,650 | 2,524 | 2,296 |
| Administration | 1,162 | 1,226 | 1,162 |
| Other services | 248 | 348 | 222 |
| | 9,560 | 8,187 | 17,196 |
| **Net revenue (expense)** | $ (510) | 345 | (9,750) |
| **Net (liabilities) assets at beginning of year** | | (6,191) | 3,559 |
| **Net liabilities at end of year** | | $ (5,846) | $ (6,191) |

*The accompanying notes are part of these financial statements.*

ALBERTA RISK MANAGEMENT FUND

# NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended March 31, 2005 *(thousands)*

## NOTE 1 AUTHORITY, PURPOSE AND FINANCIAL STRUCTURE

The Alberta Risk Management Fund (the Fund) operates under the authority of the *Financial Administration Act,* Chapter F-12, Revised Statutes of Alberta 2000.

The Fund facilitates the provision of risk management and insurance services to government departments, other entities within the Alberta Government, members of the Legislative Assembly and others by assuming general and automobile liability and the risk of property and other losses in exchange for premiums related to the level of risk assumed.

In the ordinary course of business, the Fund insures certain risks for the purpose of limiting its exposure to large or unusual risks. As such, the Fund enters into excess of loss contracts with only the most credit-worthy insurance companies and is required to pay for all losses up to certain predetermined amounts. The insurance companies compensate the Fund for any losses above the agreed predetermined amounts.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The accounting policies of significance to the Fund are as follows:

(a) Claims provisions, including provisions for claims incurred but not reported, are based on estimates made by management. The provisions are adjusted in the period when more experience is acquired and as additional information is obtained.

(b) In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Fund's liability for accrued claims. Uncertainty arises because the Fund's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Fund's liability for accrued claims, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are adjusted in the period when the actual values are known.

ALBERTA RISK MANAGEMENT FUND

**NOTE 2 (continued)**

(c) The fair values of cash and cash equivalents, accounts receivable, accrued recoveries, accounts payable and liability for accrued claims are estimated to approximate their book values.

(d) A statement of changes in cash flows is not provided as disclosure in these financial statements is considered adequate.

## NOTE 3 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of a deposit in the Consolidated Cash Investment Trust Fund (CCITF). The CCITF is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. As at March 31, 2005, securities held by the CCITF have an average effective market yield of 2.8% (2004 2.1%) per annum and an average duration of 131 days (2004 142 days).

## NOTE 4 ACCRUED RECOVERIES

Accrued recoveries represent management's best estimates of amounts that will be recovered for subrogation or salvage. All amounts are considered to be good and recoverable when due.

## NOTE 5 ACCOUNTS PAYABLE

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Payable to Department of Finance | $ 405 | $ 426 |
| Other | 124 | - |
| | $ 529 | $ 426 |

ALBERTA RISK MANAGEMENT FUND

## NOTE 6 LIABILITY FOR ACCRUED CLAIMS

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Outstanding claims case reserves (a) | $ 13,462 | $ 12,955 |
| Incurred but not reported losses (b) | 12,267 | 12,300 |
| | $ 25,729 | $ 25,255 |

**(a) Outstanding Claims Case Reserves**

Liability for outstanding claims case reserves represents management's best estimates of outstanding losses which have been reported but are not yet closed, and expenses for claims net of participant deductibles and recoveries, if any. The amount reflects management's best estimate of the ultimate cost of settlement after consultation with legal counsel if required.

**(b) Incurred But Not Reported (IBNR) Losses**

Liability for IBNR losses is an estimate of liabilities for claims that have been incurred but have not yet been reported. The amount includes a provision for development of outstanding case reserves, a provision for reopened claims, and a provision for claims that have been reported but are not yet recorded in the books.

An actuarial review of the Fund's liability for IBNR losses was carried out as at March 31, 2005 by KPMG LLP. The actuary's estimate of the Fund's liability for IBNR losses as at March 31, 2005 amounts to $12.267 million, taking into account the growth in claims and new claim types up to that date.

Liability for IBNR losses as at March 31, 2005 was determined using generally accepted actuarial practices in Canada, including the selection of appropriate assumptions and methods. The assumptions used were developed based on the best estimates of expected loss development trends and outcome of other future events.

Liability for IBNR losses represents the difference between the actuary's estimated ultimate incurred loss and the amount of incurred loss reported on the effective date of review, adjusted for the portion of any individual large claims ceded to third party insurers.

The Fund's future experience will inevitably differ, perhaps significantly, from the actuary's estimate due to the unpredictable nature of new claim types, the random occurrence of large losses and the outcome of future contingent events. Any differences between the actuary's estimate and future experience will emerge as gains or losses in future reviews and will affect the financial position of the Fund.

ALBERTA RISK MANAGEMENT FUND

## NOTE 7 CONTINGENT LIABILITIES

At March 31, 2005, the Province was named as defendant in various legal actions relating to insurance claims. The resulting loss, if any from these claims and other potential claims cannot be determined.

## NOTE 8 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

# PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Provincial Judges and Masters in Chambers Reserve Fund as at March 31, 2005 and the statement of changes in net assets for the year then ended. These financial statements are the responsibility of the management of the Fund. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the changes in net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 5) |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents (Note 3) | $ 38,437 | $ 30,399 |
| Receivable from the Province of Alberta | 394 | 1,447 |
| | 38,831 | 31,846 |
| **Liabilities** | | |
| Amounts owing to the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan (Notes 2(c ) and 4) | 38,831 | 31,846 |
| **Net Assets** | $ - | $ - |

## STATEMENT OF CHANGES IN NET ASSETS

Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 Restated (Note 5) |
|---|---|---|
| **Increase in assets** | | |
| Contributions from the Province of Alberta | | |
| Current service | $ 5,297 | $ 3,989 |
| Unfunded liabilities | 862 | 521 |
| Investment income | 826 | 851 |
| | 6,985 | 5,361 |
| **Decrease in assets** | | |
| Increase in amounts owing to the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan | 6,985 | 5,361 |
| **Increase in net assets** | - | - |
| **Net assets at beginning of year** | - | - |
| **Net assets at end of year** | $ - | $ - |

*The accompanying notes are part of these financial statements.*

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

# NOTES TO THE FINANCIAL STATEMENTS

Year Ended March 31, 2005

## NOTE 1 AUTHORITY AND PURPOSE

The Provincial Judges and Masters in Chambers Reserve Fund (Reserve Fund) operates under the authority of the *Financial Administration Act,* Chapter F-12, Revised Statutes of Alberta 2000 and the Provincial Judges and Masters in Chambers Reserve Fund Directive (*Treasury Board Directive 03/01)*.

The Reserve Fund is established to collect contributions from the Province of Alberta and to invest the funds which are reserved to meet future benefit payments of the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan (Unregistered Plan). The Unregistered Plan is established to provide additional pension benefits to Provincial Judges and Masters in Chambers whose pensionable earnings are in excess of the *maximum benefit accrual limit* as set out in the federal *Income Tax Act* effective April 1, 1998.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Reserve Fund to meet future benefit payments of the Unregistered Plan.

**(b) Valuation of Assets and Liabilities**

Short-term securities included in cash and cash equivalents are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Due to their short term nature, the fair values of deposits, receivables and accrued liabilities are estimated to approximate their book values.

**(c) Liabilities**

Accrued liabilities of the Reserve Fund are funded by investment income and contributions from the Province of Alberta.

In 2004-05, current service contributions rates remained unchanged at 36.04% of the pensionable earnings of Provincial Judges and Masters in Chambers that were in excess of the *maximum benefit accrual limit*. The rate was determined by the Unregistered Plan's actuary and approved by the Minister of Finance.

**NOTE 2 (continued)**

The unfunded liability arising as a result of judicial salary increases recommended by the 2003 Judicial Compensation Commission is financed by additional contributions from the Province of Alberta. The contribution rate is set on the basis that the additional contributions will eliminate the unfunded liability over 15 years.

These amounts represent assets held by the Reserve Fund, which are available to meet future benefit payments of the Unregistered Plan over the long term.

## NOTE 3 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of a deposit in the Consolidated Cash Investment Trust Fund (CCITF). The CCITF is managed with the objectives of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. As at March 31, 2005, securities held by the CCITF had an average effective market yield of 2.8% (2004 2.1%) per annum and an average duration of 131 days (2004 142 days).

## NOTE 4 PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (UNREGISTERED) PENSION PLAN (UNREGISTERED PLAN)

An actuarial valuation of the Unregistered Plan was carried out as at March 31, 2003 by Johnson Incorporated and was then extrapolated to March 31, 2005.

As at March 31, 2005, the Unregistered Plan reported an actuarial deficiency of $0.5 million (2004 surplus of $0.3 million), taking into account the amounts owing from the Reserve Fund.

## NOTE 5 COMPARATIVE FIGURES

Additional contributions from the Province of Alberta to retire unfunded liabilities of the Unregistered Plan were deposited into the Reserve Fund in 2004-05.

Comparative figures have been restated to be consistent with 2004-05 presentation.

## NOTE 6 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

# SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the balance sheet of the Supplementary Retirement Plan Reserve Fund as at March 31, 2005 and the statement of changes in net assets for the year then ended. These financial statements are the responsibility of the management of the Fund. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2005 and the changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Investments (Note 3) | $ 19,812 | $ 17,491 |
| Accrued interest | 11 | - |
| Receivable from participating employers | 224 | 280 |
| | 20,047 | 17,771 |
| **Liabilities** | | |
| Amounts owing to the Supplementary Retirement Plan for Public Service Managers (Notes 2(f) and 6) | 20,047 | 17,771 |
| **Net Assets** | $ - | $ - |

## STATEMENT OF CHANGES IN NET ASSETS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Increase in assets** | | |
| Contributions from participating employers | $ 1,043 | $ 2,680 |
| Net investment income (Note 7) | 1,233 | 526 |
| | 2,276 | 3,206 |
| **Decrease in assets** | | |
| Increase in amounts owing to the Supplementary Retirement Plan for Public Service Managers | 2,276 | 3,205 |
| Administration expenses | - | 1 |
| | 2,276 | 3,206 |
| **Increase in net assets** | - | - |
| **Net assets at beginning of year** | - | - |
| **Net assets at end of year** | $ - | $ - |

*The accompanying notes and schedules are part of these financial statements.*

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

## NOTE 1 AUTHORITY AND PURPOSE

The Supplementary Retirement Plan Reserve Fund (Reserve Fund) operates under the authority of the *Financial Administration Act,* Chapter F-12, Revised Statutes of Alberta 2000 and Treasury Board Directive 05/99.

The Reserve Fund is established to collect contributions from participating employers and to invest the funds which are reserved to meet future benefit payments of the Supplementary Retirement Plan for Public Service Managers (SRP). The SRP is established effective July 1, 1999 to provide additional pension benefits to eligible public service managers whose pensionable earnings are in excess of the maximum benefit accrual limit as set out by the federal *Income Tax Act*.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

### a) Basis of Presentation

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Reserve Fund to meet future benefit payments of the SRP.

The Reserve Fund's investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

### b) Valuation of Assets and Liabilities

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Reserve Fund or by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

**NOTE 2 (continued)**

Real estate investments are reported at their most recent appraised value net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

Due to their short term nature, the fair values of deposits, receivables, accrued investment income and accrued liabilities are estimated to approximate their book values.

**c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange except for hedged foreign currency transactions, which are translated at rates of exchange established by the terms of the forward exchange contracts. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

**NOTE 2 (continued)**

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Liabilities**

Accrued liabilities of the Reserve Fund are funded by investment income and contributions from participating employers. Contribution rates are set by the Minister of Finance, taking into account recommendations of the SRP's actuary.

The rate in effect at March 31, 2005 remained unchanged at 6.8% of the pensionable salaries of eligible public service managers that were in excess of the maximum benefit accrual limit.

These amounts represent assets held by the Reserve Fund, which are available to meet future benefit payments of the SRP over the long term.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## NOTE 3 INVESTMENTS (SCHEDULES A TO E)

*(thousands)*

| | 2005 Fair Value | % | 2004 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 65 | 0.3 | $ 11,997 | 68.6 |
| Canadian Dollar Public Bond Pool (b) | 6,544 | 33.0 | 2,993 | 17.1 |
| Real rate of return bonds (c ) | 1,122 | 5.7 | - | - |
| Private Mortgage Pool (d) | 1,096 | 5.5 | - | - |
| Total fixed income securities | 8,827 | 44.5 | 14,990 | 85.7 |
| **Canadian Equities (Schedule B)** | | | | |
| Domestic Passive Equity Pooled Fund (e) | 2,351 | 11.9 | 187 | 1.1 |
| External Managers | | | | |
| Canadian Equity Enhanced Index Pool (f) | 362 | 1.8 | - | - |
| Canadian Large Cap Equity Pool (g) | 235 | 1.2 | 146 | 0.8 |
| Canadian Multi-Cap Pool (h) | 153 | 0.8 | - | - |
| Canadian Pooled Equities Fund | 33 | 0.2 | - | - |
| Overlay US Equity Pool (k) | (201) | (1.0) | - | - |
| | 2,933 | 14.9 | 333 | 1.9 |
| **United States Equities (Schedule C)** | | | | |
| S&P 500 Pooled Index Fund (i) | 3,080 | 15.6 | 606 | 3.5 |
| External Managers | | | | |
| US Small/Mid Cap Equity Pool (j) | 398 | 2.0 | - | - |
| US Large Cap Equity Pool | - | - | 506 | 2.9 |
| Overlay US Equity Pool (k) | 241 | 1.2 | - | - |
| | 3,719 | 18.8 | 1,112 | 6.4 |
| **Non-North American Equities (Schedule D)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (l) | 1,792 | 9.0 | 533 | 3.0 |
| EAFE Plus Equity Pool (l) | 927 | 4.7 | 269 | 1.5 |
| EAFE Passive Equity Pool (m) | 818 | 4.1 | 254 | 1.5 |
| Emerging Markets Equity Pool (n) | 203 | 1.0 | - | - |
| | 3,740 | 18.8 | 1,056 | 6.0 |
| **Real Estate Equities (Schedule E)** | | | | |
| Private real estate Pool (o) | 593 | 3.0 | - | - |
| Total equities | 10,985 | 55.5 | 2,501 | 14.3 |
| **Total investments** | $ 19,812 | 100.0 | $ 17,491 | 100.0 |

a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

**NOTE 3 (continued)**

(c) Real rate of return bonds are issued or guaranteed by the Government of Canada and bear interest at a fixed rate adjusted for inflation.

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. To limit investment risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(e) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(f) The External Managers Canadian Equity Enhanced Index Pool consists of single portfolio of publicly traded Canadian equities in the large cap market and is designed to generate a consistent level of investment return above the total return of the S&P/TSX Composite Index over a four-year period with relatively low risk.

(g) The External Managers Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple managers, each of whom has a different investment style and market capitalization focus.

(h) The Canadian Multi-Cap Pool consists of a single portfolio with multiple components. The large cap component is internally managed and provides exposure to the Canadian equity market through structured investments replicating the S&P/TSX 60 Index. The small/mid cap component is comprised of investments in the External Managers Canadian Multi-Cap Pool. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period.

(i) The S&P 500 Pooled Index Fund is passively managed. The portfolio is comprised of publicly traded United States equities similar in weights to the Standard & Poor's (S&P) 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. The pool utilizes a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pool also invests in futures, swaps and other structured investments.

(j) The External Managers US Small/Mid Cap Equity Pool consists of a single portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the US small and mid cap equity markets. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.

(k) The Overlay US Equity Pool is managed with the objective of providing a quick, effective and efficient way to reduce exposure to Canadian equities and increase exposure to United States equities through synthetic instruments on a largely unfunded basis. The Pool is comprised of a long position through United States equity index futures contracts and a short position through Canadian equity index futures contracts. Cash and short-term securities held by the Pool support approximately 5% to 10% of the Pool's notional exposure in Canadian and United States equity index futures contracts.

(l) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each Core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

**NOTE 3 (continued)**

(m) The External Managers EAFE Passive Equity Pool's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The pool consists of a single portfolio of Non-North American publicly traded equities similar in weights to the MSCI EAFE index.

(n) The External Managers Emerging Markets Equity Pool consists of a single portfolio of publicly traded equities in emerging markets around the world. The portfolio is actively managed by an external manager with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International Emerging Markets Free (MSCI EMF) Index over a four-year period.

(o) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediate companies, which have issued to the pool common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn the best possible return at an acceptable level of risk, management has established a benchmark policy asset mix of 45% fixed income instruments and 55% equities to the combined assets available for investments of the Reserve Fund and the SRP. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Reserve Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

**NOTE 5 (continued)**

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies.

There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Reserve Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005:

*(thousands)*

| | Maturity Under 1 Year | 1 to 3 Years | Over 3 Years | 2005 Notional Amount | 2005 Net Fair Value | 2004 Notional Amount | 2004 Net Fair Value |
|---|---|---|---|---|---|---|---|
| Equity index swap contracts | 73% | 27% | - | $ 2,867 | $ 24 | $ 313 | $ (4) |
| Cross-currency interest rate swap contracts | 8% | 32% | 60% | 1,278 | 9 | 276 | (42) |
| Interest rate swap contracts | 38% | 49% | 13% | 1,127 | (29) | 195 | (9) |
| Equity index futures contracts | 100% | - | - | 439 | 6 | 5 | - |
| Forward foreign exchange contracts | 100% | - | - | 414 | 3 | 34 | - |
| Credit default swap contracts | 32% | 11% | 57% | 290 | 3 | 24 | - |
| Bond index swap contracts | 100% | - | - | 127 | 1 | 42 | 1 |
| | | | | $ 6,542 | $ 17 | $ 889 | $ (54) |

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Reserve Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## NOTE 6 SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS (SRP)

An actuarial valuation of the SRP was carried out as at December 31, 2002 by Aon Consulting Inc. and was then extrapolated to December 31, 2004.

As at December 31, 2004, the SRP reported an actuarial surplus of $9.4 million (2003 $9.3 million), taking into account the amounts owing from the Reserve Fund.

## NOTE 7 NET INVESTMENT INCOME

Net investment income is comprised of the following:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Net realized and unrealized gains (losses) on investments, including those arising from derivative transactions | $ 499 | $ (29) |
| Interest income | 568 | 546 |
| Dividend income | 167 | 10 |
| Real estate income | 21 | - |
| Security lending income | 3 | - |
| Administration expenses | (25) | (1) |
| | $ 1,233 | $ 526 |

The following is a summary of the Fund's proportionate share of net investment income by type of investments:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Fixed Income Securities | $ 591 | $ 495 |
| Canadian Equities | 457 | 3 |
| Foreign Equities | | |
| United States | (117) | 12 |
| Non-North American | 232 | 16 |
| Real Estate | 70 | - |
| | $ 1,233 | $ 526 |

## NOTE 8 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

# SCHEDULES TO THE SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

March 31, 2005 *(thousands)*

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 86 | $ 12,002 |
| **Fixed income securities (a)** | | |
| Government of Canada, direct and guaranteed | 3,077 | 713 |
| Provincial, direct and guaranteed | | |
| Alberta | 4 | 2 |
| Other | 1,580 | 714 |
| Municipal | 83 | 41 |
| Corporate, public and private | 3,944 | 1,526 |
| | 8,688 | 2,996 |
| Receivable from sale of investments and accrued investment income | 91 | 35 |
| Liabilities for investment purchases | (38) | (43) |
| | 53 | (8) |
| | $ 8,827 | $ 14,990 |

(a) Fixed income securities held as at March 31, 2005 had an average effective market yield of 4.15% (2004 4.20%) per annum. The following term structure of these securities as at March 31, 2005 was based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| Under 1 year | 2 | 2 |
| 1 to 5 years | 32 | 40 |
| 6 to 10 years | 30 | 30 |
| 11 to 20 years | 17 | 10 |
| Over 20 years | 19 | 18 |
| | 100 | 100 |

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

March 31, 2005 *(thousands)*

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 7 | $ 4 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 179 | 24 |
| Consumer staples | 123 | 13 |
| Energy | 592 | 49 |
| Financials | 911 | 106 |
| Health care | 41 | 7 |
| Industrials | 155 | 26 |
| Information technology | 169 | 26 |
| Materials | 435 | 56 |
| Telecommunication services | 184 | 16 |
| Utilities | 45 | 9 |
| | 2,834 | 332 |
| Small Cap pooled fund | 47 | - |
| Receivable from sale of investments and accrued investment income | 55 | 2 |
| Liabilities for investment purchases | (10) | (5) |
| | 45 | (3) |
| | $ 2,933 | $ 333 |

(a) The Reserve Fund's net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling $1,938 (2004 $132).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

March 31, 2005 *(thousands)*

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 63 | $ 5 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 436 | 173 |
| Consumer staples | 350 | 114 |
| Energy | 320 | 65 |
| Financials | 714 | 228 |
| Health care | 478 | 134 |
| Industrials | 455 | 125 |
| Information technology | 559 | 171 |
| Materials | 143 | 41 |
| Telecommunication services | 103 | 33 |
| Utilities | 128 | 25 |
| | 3,686 | 1,109 |
| Receivable from sale of investments and accrued investment income | 14 | 3 |
| Liabilities for investment purchases | (44) | (5) |
| | (30) | (2) |
| | $ 3,719 | $1,112 |

(a) The Reserve Fund's net investment in United States public equities includes the notional amount of U.S. equity index swap contracts and equity index futures contracts totalling $1,368 (2004 $186).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's S&P 500 Index.

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES Schedule D

March 31, 2005 *(thousands)*

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 69 | $ 21 |
| **Public equities (a)** | | |
| Consumer discretionary | 482 | 162 |
| Consumer staples | 213 | 77 |
| Energy | 316 | 79 |
| Financials | 952 | 249 |
| Health care | 221 | 80 |
| Industrials | 434 | 120 |
| Information technology | 184 | 64 |
| Materials | 314 | 81 |
| Telecommunications services | 306 | 81 |
| Utilities | 158 | 40 |
| | 3,580 | 1,033 |
| Emerging market pooled funds | 84 | - |
| Receivable from sale of investments and accrued investment income | 45 | 11 |
| Liabilities for investment purchases | (38) | (9) |
| | 7 | 2 |
| | $ 3,740 | $ 1,056 |

(a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. The following is a summary of the Reserve Fund's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased.

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| United Kingdom | $ 779 | $ 237 |
| Japan | 625 | 198 |
| France | 353 | 97 |
| Germany | 254 | 70 |
| Switzerland | 227 | 81 |
| Netherlands | 193 | 56 |
| Australia | 163 | 50 |
| Italy | 138 | 46 |
| Spain | 105 | 27 |
| Sweden | 95 | 19 |
| Other | 648 | 152 |
| | $ 3,580 | $ 1,033 |

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

March 31, 2005 *(thousands)*

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| **Real estate (a)** | | |
| Office | $ 270 | $ - |
| Retail | 240 | - |
| Industrial | 47 | - |
| Residential | 27 | - |
| | 584 | - |
| Passive index | 8 | - |
| Receivable from sale of investments and accrued investment income | 1 | - |
| | $ 593 | $ - |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

| | Reserve Fund's Share 2005 | Reserve Fund's Share 2004 |
|---|---|---|
| Ontario | $ 389 | $ - |
| Alberta | 121 | - |
| Quebec | 61 | - |
| British Columbia | 13 | - |
| | $ 584 | $ - |

SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND

## SCHEDULE OF INVESTMENT RETURNS

**Schedule F**

For the year ended March 31, 2005

The Plan uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Plan over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

| | One Year Return 2005 |
|---|---|
| **Tine-weighted rates of return** | |
| **Overall actual return** | **6.7%** |
| **Policy benchmark return** | **6.2%** |

# ALBERTA CAPITAL FINANCE AUTHORITY

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Shareholders of the Alberta Capital Finance Authority**

I have audited the balance sheet of the Alberta Capital Finance Authority as at December 31, 2004 and the statements of loss and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
January 28, 2005

Fred J. Dunn, FCA
Auditor General

ALBERTA CAPITAL FINANCE AUTHORITY

# BALANCE SHEET

As at December 31, 2004 *(thousands)*

| | Budget | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **ASSETS** | | | |
| Cash (Note 3) | $ 7,264 | $ 23,025 | $ 2,308 |
| Accrued interest receivable | 117,963 | 121,988 | 128,189 |
| Loans to local authorities (Note 4) | 3,942,045 | 4,135,820 | 3,917,098 |
| | $ 4,067,272 | $ 4,280,833 | $ 4,047,595 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Liabilities** | | | |
| Accrued interest payable | $ 52,162 | $ 56,329 | $ 52,646 |
| Debt (Note 5 and Schedule 1) | 4,004,449 | 4,211,776 | 3,972,479 |
| | 4,056,611 | 4,268,105 | 4,025,125 |
| **Shareholders' equity** | | | |
| Share capital (Note 6): | | | |
| Issued and fully paid: | | | |
| 6,376 shares (2003 - 6,373) | 64 | 64 | 64 |
| Retained earnings | 10,597 | 12,664 | 22,406 |
| | 10,661 | 12,728 | 22,470 |
| | $ 4,067,272 | $ 4,280,833 | $ 4,047,595 |

The accompanying notes and schedules are part of these financial statements.

Don Lussier
Chair of the Board

T.S. Stroich, FCA
President

ALBERTA CAPITAL FINANCE AUTHORITY

## STATEMENT OF LOSS AND RETAINED EARNINGS

For the year ended December 31, 2004 *(thousands)*

| | Budget | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **Interest Income** | | | |
| Loans | $ 301,620 | $ 298,412 | $ 311,113 |
| Amortization of loan discounts | 9,175 | 9,175 | 12,243 |
| Other | 2,800 | 2,815 | 967 |
| | 313,595 | 310,402 | 324,323 |
| **Interest Expense** | | | |
| Debt | 323,820 | 319,704 | 323,939 |
| Amortization of net discounts on debt | 979 | 1,378 | 4,642 |
| | 324,799 | 321,082 | 328,581 |
| Net interest expense | (11,204) | (10,680) | (4,258) |
| **Other Income** | | | |
| Loan prepayment fees | - | 1,577 | 485 |
| Net interest expense and other income | (11,204) | (9,103) | (3,773) |
| **Non-Interest Expense** | | | |
| Administration and office expenses (Note 7) | 875 | 639 | 497 |
| **Net loss** | (12,079) | (9,742) | (4,270) |
| **Retained earnings, beginning of year** | 22,676 | 22,406 | 26,676 |
| **Retained earnings, end of year** | $ 10,597 | $ 12,664 | $ 22,406 |

ALBERTA CAPITAL FINANCE AUTHORITY

## STATEMENT OF CASH FLOWS

For the year ended December 31, 2004 *(thousands)*

| | Budget | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **Operating Activities** | | | |
| Interest received | $ 311,850 | $ 304,613 | $ 318,573 |
| Other interest | 2,800 | 2,815 | 967 |
| Loan prepayment fees | - | 1,577 | 485 |
| Administration and office expenses | (875) | (639) | (497) |
| Interest paid | (323,655) | (316,021) | (330,328) |
| Cash flows used in operating activities | (9,880) | (7,655) | (10,800) |
| **Investing Activities** | | | |
| Loan repayments | 383,461 | 397,916 | 410,372 |
| New loans issued | (400,000) | (607,463) | (496,957) |
| Cash flows used in investing activities | (16,539) | (209,547) | (86,585) |
| **Financing Activities** | | | |
| Debt issues | 459,899 | 713,410 | 3,124,186 |
| Debt redemptions | (431,320) | (475,491) | (2,930,523) |
| Cash flows from financing activities | 28,579 | 237,919 | 193,663 |
| Payment of retained earnings to General Revenue Fund | - | - | (100,000) |
| **Net increase (decrease) in cash** | 2,160 | 20,717 | (3,722) |
| **Cash, beginning of year** | 5,104 | 2,308 | 6,030 |
| **Cash, end of year** | $ 7,264 | $ 23,025 | $ 2,308 |

ALBERTA CAPITAL FINANCE AUTHORITY

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

*(all amounts presented in thousands of dollars, except share amounts)*

## NOTE 1 AUTHORITY

The Alberta Capital Finance Authority (formerly the Alberta Municipal Financing Corporation) operates under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

These financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP) and include the following significant accounting policies:

**(a) Debt**

Debt premiums and discounts, including underwriting commission, arising on the issue of debt are deferred and amortized over the term of the debt.

Debt is recorded net of unamortized premiums or discounts.

Public debt issue expenses are charged against income as they are incurred.

**(b) Discounts on Loans to Local Authorities**

Discounts are recorded for reductions of interest rates given on loans to local authorities with interest rates above a certain level and are amortized to income over the term of these loans. Annual amortization is the change in the present value of the remaining interest rate reduction.

**(c) Measurement Uncertainty**

The preparation of financial statements in conformity with Canadian GAAP 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 the reported amount of revenues and expenses during the year. Actual results could differ from these estimates. Measurement uncertainty exists in the valuation of the loans to local authorities.

**(d) Credit Risk**

Credit risk is the risk of loss due to borrowers failing to meet their obligations to the Authority. Historically, the Authority has not needed to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority has established policies, which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

ALBERTA CAPITAL FINANCE AUTHORITY

**NOTE 2 (continued)**

**(e) Derivative Financial Instruments**

Derivative financial instruments used by the Authority are interest rate contracts whose value is derived from interest rates and are used to accommodate the management of risk for asset/liability management purposes and to manage the Authority's interest rate exposure.

The Authority designates each derivative financial instrument as a hedge of identified assets or liabilities. In order to designate a derivative financial instrument as a hedge for accounting purposes, the criteria of Accounting Guideline 13, Hedging Relationships must be met. As a result, the Authority formally documents all relationships between hedging instruments and hedging items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivative financial instruments to specific assets and liabilities. The Authority also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Derivative financial instruments are accounted for on an accrual basis. Income and expenses on derivative financial instruments designated and qualifying as hedges are recorded as an adjustment to the yield of the item being hedged over the term of the hedge contract in the Statement of Loss and Retained Earnings. Accrued interest receivable and payable on these derivative financial instruments are recorded in accrued interest receivable and payable respectively, in the Balance Sheet.

If the hedge is no longer effective, the associated derivative financial instrument is subsequently carried at fair value on the Balance Sheet and the fair value and any subsequent changes to the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Derivative financial instruments that have been acquired for asset/liability management purposes that do not qualify for hedge accounting are carried at fair value on the Balance Sheet and the fair value and any subsequent changes in the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Accrued income and expenses and deferred gains and losses are included in other assets and other liabilities as appropriate in the Balance Sheet.

## NOTE 3 CASH

Cash consists of deposits in the Consolidated Cash Investment Trust Fund (CCITF) of the Province of Alberta. CCITF is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

ALBERTA CAPITAL FINANCE AUTHORITY

## NOTE 4 LOANS TO LOCAL AUTHORITIES

| | 2004 | 2003 |
|---|---|---|
| Loans to local authorities | $ 4,150,205 | $ 3,940,658 |
| Less: Unamortized discounts | 14,385 | 23,560 |
| | $ 4,135,820 | $ 3,917,098 |

## NOTE 5 DEBT

(a) The debt of the Authority is fully guaranteed by the Province of Alberta.

(b) Debt amounting to $2,204,567 (2003 - $2,465,058) held by the Canada Pension Plan Investment Fund (CPPIF) is redeemable at the option of the Minister of Finance of Canada by giving six months notice in writing and observing the other redemption provisions of the debt agreement.

(c) Debt amounting to $302,000 (2003 - Nil) is comprised of a combination of various issues of step-up and accrual notes whereby the Authority has the option of extending or calling the debt, at predetermined extension on call dates. Principal is due upon termination of the debt, where debt is called or not extended by the Authority at the predetermined extension or call date, or upon final maturity of the debt (Schedule 1).

(d) Debt redemption requirements, with the assumption that the step-up and accrual notes are redeemed at the first extendible date and all other debt at the maturity date (Schedule 1), are as follows:

| | Debt Redemption |
|---|---|
| 2005 | $ 725,604 |
| 2006 | 395,396 |
| 2007 | 335,383 |
| 2008 | 259,294 |
| 2009 | 330,523 |
| | $ 2,046,200 |

ALBERTA CAPITAL FINANCE AUTHORITY

## NOTE 6 SHARE CAPITAL

Particulars of share capital are as follows:

| | | Number of Shares | | |
|---|---|---|---|---|
| **Class** | **Restricted to** | **Authorized** | **Issued and Fully Paid** | **Total Dollar Amount** |
| A | Province of Alberta | 4,500 | 4,500 | $ 45,000 |
| B | Municipal authorities, airport and health authorities | 1,000 | 859 | 8,590 |
| C | Cities | 750 | 582 | 5,820 |
| D | Towns and villages | 750 | 299 | 2,990 |
| E | Educational authorities | 500 | 136 | 1,360 |
| | | 7,500 | 6,376 | $ 63,760 |

During the year, four Class B shares were issued and one Class D share was cancelled at $10.00 each.

## NOTE 7 DIRECTORS' FEES AND RELATED PARTY TRANSACTIONS

Directors' fees paid by the Authority are as follows:

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | **Number of Individuals** | **Total** | **Number of Individuals** | **Total** |
| Chair of the Board | 1 | $ 5 | 1 | $ 7 |
| Board members | 6 | $ 18 | 6 | $ 19 |

There are two additional Board members who are employees of the Province of Alberta and do not receive compensation from the Authority.

The Authority has advanced loans to local authorities under the ME *first*! Municipal Energy Efficiency Assistance program (the "Program") on behalf of the Alberta Municipal Affairs and Alberta Environment. Under the Program, principal is advanced to qualifying municipalities by the Authority and repayments of principal are made by the municipality; however, the interest is paid by the Province of Alberta. Included in the balance of loans to local authorities at December 31, 2004 is principal of $5,536 (2003 - Nil), upon which, interest of $122 (2003 - Nil) has been recorded in interest income from loans.

The Authority has no employees. Included in administration and office expenses of $639 (2003 - $497) is the amount of $331 (2003 - $287) that was paid to the controlling shareholder, Province of Alberta for goods and services at prices which approximate market.

ALBERTA CAPITAL FINANCE AUTHORITY

## NOTE 8 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments used by the Authority include all interest rate swaps and forward rate agreements. The Authority enters into derivative financial instruments for risk management purposes and does not act as an intermediary in this market.

The interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt made after January 1, 2004.

Notional amounts represent the amount to which a rate is applied in order to calculate the exchange of cash flows. The notional amounts are not recorded in the Balance Sheet. They represent the volume of outstanding transactions and do not represent the potential gain or loss associated with the market risk or credit risk of such instruments.

The notional amounts of derivative financial instruments are summarized as follows:

AS AT DECEMBER 31, 2004

| Maturities | Within 1 Year | 1 to 2 Years | 3 to 5 Years | 6 to 10 Years | Over 10 Years | 2004 Total |
|---|---|---|---|---|---|---|
| **Interest rate contracts** | | | | | | |
| Interest rate swaps | $302,000 | $ - | $ 46,713 | $ 162,251 | $ 647,196 | $1,158,160 |

The cost of replacing the remaining cash flows of the derivative financial instruments at the prevailing prices and market rates are summarized as follows:

AS AT DECEMBER 31, 2004

| Maturities | Notional Outstanding | Net Fair Value | Current Replacement Cost Favourable Position | Current Replacement Cost Unfavourable Position |
|---|---|---|---|---|
| **Interest rate contracts** | | | | |
| Interest rate swaps | $ 1,158,160 | $ (3,595) | $ 12,308 | $ (15,903) |

Fair values are determined using pricing models which take into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions. Fair values have been segregated between those contracts which are in a favourable position (positive fair value) and those contracts which are in an unfavourable position (negative fair value).

Current credit exposure is limited to the amount of loss that the Authority would suffer if every counterparty to which the Authority was exposed were to default at once and is represented by the current replacement cost of all outstanding contracts in a favourable position. The Authority actively monitors their exposure and minimizes credit risk by only dealing with counterparties believed to be credit worthy.

ALBERTA CAPITAL FINANCE AUTHORITY

## NOTE 9 INTEREST RATE RISK

Interest rate risk refers to the potential impact of changes in interest rates on the Authority's earnings when maturities of its financial assets are not matched with the maturities of its financial debt. The following table summarizes the carrying amounts of the Authority's interest sensitive assets and liabilities based on the earlier of contractual repricing or maturity date:

AS AT DECEMBER 31, 2004

| Maturities | Within 1 Year | 1 to 2 Years | 3 to 5 Years | 6 to 10 Years | Over 10 Years | 2004 Total | | 2003 Total |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash | $ 23,025 | $ - | $ - | $ - | $ - | $ 23,025 | | $ 2,308 |
| Accrued Interest Receivable | 121,988 | - | - | - | - | 121,988 | | 128,189 |
| Loans | 492,157 | 365,899 | 1,134,089 | 1,054,102 | 1,103,958 | 4,150,205 | (i) | 3,940,658 |
| Effective Rate | 6.5% | 10.5% | 9.1% | 7.5% | 6.2% | 7.2% | | 7.8% |
| Total | $ 637,170 | $ 365,899 | $1,134,089 | $1,054,102 | $ 1,103,958 | $ 4,295,218 | | $4,071,155 |
| **Liabilities** | | | | | | | | |
| Accrued Interest Payable | $ 56,329 | $ - | $ - | $ - | $ - | $ 56,329 | | $ 52,646 |
| Debt | 725,502 | 395,396 | 925,200 | 1,246,795 | 918,883 | 4,211,776 | | 3,972,479 |
| Effective Rate | 7.2% | 9.9% | 9.9% | 5.6% | 5.7% | 7.3% | | 8.1% |
| Total | $ 781,831 | $ 395,396 | $ 925,200 | $1,246,795 | $ 918,883 | $ 4,268,105 | | $4,025,125 |
| Net Gap | $ (144,661) | $ (29,497) | $ 208,889 | $ (192,693) | $ 185,075 | $ 27,113 | | $ 46,030 |

(i) This total is not reduced by unamortized discount of $14,385 (2003 - $23,560).

The Authority manages on a continuous basis its interest rate risk by matching its debt maturity profile to the forecast cash flows and their effect on the Authority's surplus position. For loans made after January 1, 2004, the Authority uses financial derivative financial instruments to swap fixed rate loans interest to floating, and swap corresponding debt from fixed rate to floating, and use forward rate contracts to minimize the exposure related to the mismatch of reset dates of the loan and debt swaps.

## NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS

The amounts set out in the table represent the fair value of the Authority's financial instruments based on the following assumptions and valuation methods.

Fair value represents the estimated consideration that would be agreed upon in a current transaction between knowledgeable, willing parties who are under no compulsion to act. For loans and debt, fair value is calculated using net present value techniques where the Authority's future cash flows are discounted at the Authority's current cost of funds.

ALBERTA CAPITAL FINANCE AUTHORITY

**NOTE 10 (continued)**

Changes in interest rates are the main cause of changes in the fair value of the Authority's financial instruments. The fair value of cash approximates its carrying value.

The following table presents the financial instruments with a carrying value different from the recorded value at December 31:

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | **Fair Value** | **Book Value** | **Fair Value** | **Book Value** |
| Loans, including accrued interest receivable | $ 4,737,552 | $ 4,257,808 | $ 4,571,827 | $ 4,045,287 |
| Debt, including accrued interest payable | $ 4,704,483 | $ 4,268,105 | $ 4,505,138 | $ 4,025,125 |

Fair value of derivative financial instruments is provided in Note 8.

## NOTE 11 COMMITMENTS

**Lease**
The Authority has obligations under a operating lease for the rental of premises at an annual minimum amount of $25 expiring in July 2008.

**Credit Commitments**
In the normal course of business, the Authority enters into loan commitments to provide customers with sources of credit.

Commitments to extend credit represent undertakings to make credit available in the form of loans for specific amounts and maturities, subject to certain conditions and are recently authorized loans not yet drawn down.

These loan arrangements are subject to the Authority's normal credit standards and collateral is obtained where appropriate. The loan amounts represent the maximum credit risk exposure to the Authority should the loans be fully drawn. These arrangements will most likely be drawn upon; the loan amounts represent future cash requirements. Loan commitments as at December 31 were:

| | 2004 | 2003 |
|---|---|---|
| Loans commitments as at December 31 | $ 28,600 | $ - |

## NOTE 12 BUDGET

The 2004 budget was approved by the Board of Directors on November 24, 2003.

ALBERTA CAPITAL FINANCE AUTHORITY

## SCHEDULE OF DEBT

**Schedule 1**

As at December 31, 2004 *(thousands)*

| Maturity Date | First Extendible Date | Interest Rate % | Principal Outstanding | |
|---|---|---|---|---|
| **Canada Pension Plan Investment Fund (Note5(b))** | | | | |
| Nov 01, 2005 | | 11.66 | $ 283,604 | |
| Nov 03, 2006 | | 9.85 | 395,396 | |
| Nov 02, 2007 | | 9.66 | 335,383 | |
| Oct 03, 2008 | | 10.04 | 259,294 | |
| Oct 02, 2009 | | 9.99 | 291,414 | |
| Nov 01, 2009 | | 9.62 | 32,457 | |
| Dec 01, 2009 | | 9.26 | 6,652 | |
| Oct 01, 2020 | | 6.280 | 222,367 | |
| Jun 01, 2022 | | 6.060 | 100,000 | |
| Apr 05, 2023 | | 5.890 | 50,000 | |
| Dec 01, 2023 | | 5.500 | 150,000 | |
| Dec 03,2024 | | 5.180 | 78,000 | |
| **Total** | | | 2,204,567 | |
| **Public** | | | | |
| Jun 01, 2005 | | 4.600 | 140,000 | |
| Jun 15, 2009 | Jun 15, 2005 | 4.000 | 40,000 | (i) |
| Jun 21, 2009 | Jun 21, 2005 | 4.000 | 40,000 | (i) |
| Sep 15, 2009 | Sep 15, 2005 | 3.000 | 10,000 | (i) |
| Mar 01, 2010 | | 4.550 | 50,000 | |
| Jun 15, 2010 | Jun 15, 2005 | 4.550 | 10,000 | (ii) |
| Jun 15, 2010 | Jun 15, 2005 | 3.500 | 15,000 | (i) |
| Jun 23, 2010 | Jun 23, 2005 | 4.000 | 30,000 | (i) |
| Aug 20, 2010 | | 4.500 | 150,000 | |
| Jun 21, 2011 | Jun 21, 2005 | 4.300 | 22,000 | (i) |
| Sep 01, 2011 | | 5.700 | 200,000 | |
| Dec 15, 2011 | | 4.435 | 50,000 | |
| Jun 01, 2012 | | 5.850 | 500,000 | |
| Jun 23, 2012 | Jun 23, 2005 | 4.000 | 40,000 | (i) |
| Dec 02, 2013 | | 5.000 | 300,000 | |
| Sep 15, 2014 | Sep 15, 2005 | 4.050 | 15,000 | (i) |
| Dec 15, 2014 | Dec 15, 2005 | 4.000 | 25,000 | (i) |
| Dec 15, 2014 | Dec 15, 2005 | 4.300 | 30,000 | (i) |
| Jun 01, 2015 | | 4.900 | 200,000 | |
| Jun 01, 2018 | | 5.150 | 100,000 | |
| Jun 23, 2019 | Jun 23, 2005 | 6.000 | 25,000 | (ii) |
| Dec 01, 2023 | | 5.100 | 20,000 | |
| **Total** | | | 2,012,000 | |
| | | | 4,216,567 | |
| **Net unamortized discount** | | | 4,791 | |
| **Total debt 2004** | | | $ 4,211,776 | |
| **Total debt 2003** | | | $ 3,972,479 | |

(i) These are step-up notes extendible at the Authority's option which pay interest periodically at a predetermined rate with principal paid on termination.

(ii) These are accrual notes extendible or callable at the Authority's option which accrue interest semi-annually and pay interest and principal on termination.

# ALBERTA INSURANCE COUNCIL

## Financial Statements
YEAR ENDED DECEMBER 31, 2004

# AUDITORS' REPORT

**To the Members of Alberta Insurance Council**

We have audited the statement of financial position of Alberta Insurance Council as at December 31, 2004 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 Council'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 Council as at December 31, 2004, the results of its operations, the changes in its net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Alberta
March 8, 2005

PricewaterhouseCoopers LLP
Chartered Accountants

ALBERTA INSURANCE COUNCIL

## STATEMENT OF FINANCIAL POSITION

As at December 31, 2004.

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash (Note 3) | $ 2,121,328 | $ 1,590,102 |
| Accounts receivable | 8,005 | 10,925 |
| Prepaid expenses | 34,894 | 24,542 |
| | 2,164,227 | 1,625,569 |
| **Recoverable program development costs** | 4,415 | 57,519 |
| **Deferred program and examination development costs** (Note 4) | 136,382 | 205,948 |
| **Property and equipment** (Note 5) | 225,352 | 234,145 |
| | $ 2,530,376 | $ 2,123,181 |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | $ 131,619 | $ 119,107 |
| Current portion of obligation under capital lease | 4,500 | 4,500 |
| Deferred tenant inducement | 9,067 | 13,797 |
| Deferred license and assessment fee revenue | 756,972 | 646,100 |
| | 902,158 | 783,504 |
| **Obligation under capital lease** | - | 4,500 |
| | 902,158 | 788,004 |
| **NET ASSETS** | | |
| **Net assets** | | |
| Invested in property and equipment | 220,852 | 225,145 |
| Invested in program and development | 136,382 | 205,948 |
| Unrestricted | 1,270,984 | 904,084 |
| | 1,628,218 | 1,335,177 |
| | $ 2,530,376 | $ 2,123,181 |

Approved by the Board of Directors

R.L. Audiel
Director

Nancy Stenson
Director

ALBERTA INSURANCE COUNCIL

## STATEMENT OF CHANGES IN NET ASSETS

For the Year Ended December 31, 2004

| | Invested in property and equipment | Invested in program and examination development | Unrestricted | Total 2004 | Total 2003 |
|---|---|---|---|---|---|
| **Balance - Beginning of year** | $ 225,145 | $ 205,948 | $ 904,084 | $1,335,177 | $1,818,212 |
| Excess (deficiency) of revenue over expenditures | (118,033) | (105,202) | 516,276 | 293,041 | (483,035) |
| Invested in property and equipment | 113,740 | - | (113,740) | - | - |
| Invested in program development | - | 35,636 | (35,636) | - | - |
| **Balance - End of year** | $ 220,852 | $ 136,382 | $1,270,984 | $1,628,218 | $1,335,177 |

| | 2004 | 2003 |
|---|---|---|
| **Net assets invested in property and equipment consists of:** | | |
| Property and equipment | $ 225,352 | $ 234,145 |
| Obligation under capital lease | (4,500) | (9,000) |
| | $ 220,852 | $ 225,145 |

ALBERTA INSURANCE COUNCIL

## STATEMENT OF OPERATIONS

For the year ended December 31, 2004

| | Budget 2004 (Unaudited) | 2004 | 2003 |
|---|---|---|---|
| **Revenue** | | | |
| License, assessment, examination and continuing education fees | $ 2,517,000 | $ 2,754,882 | $ 1,859,527 |
| Interest and other | 50,000 | 55,923 | 57,688 |
| | 2,567,000 | 2,810,805 | 1,917,215 |
| **Expenditures** | | | |
| Salaries and benefits | 1,450,000 | 1,416,929 | 1,299,820 |
| Occupancy | 240,000 | 215,283 | 214,366 |
| Council meetings | 183,000 | 140,481 | 151,204 |
| Amortization of property and equipment | 130,000 | 118,033 | 94,925 |
| Amortization of program development costs | 76,000 | 105,202 | 75,531 |
| Travel | 80,000 | 84,738 | 72,342 |
| Freight and postage | 92,000 | 73,776 | 76,877 |
| Legal fees | 75,000 | 64,505 | 101,130 |
| Professional fees | 70,000 | 58,708 | 40,762 |
| Software maintenance | 40,000 | 49,018 | 45,626 |
| Communications | 35,000 | 33,706 | 38,711 |
| Printing and stationery | 30,000 | 32,815 | 53,043 |
| Training | 20,000 | 20,677 | 15,760 |
| Accreditation committee | 35,000 | 20,290 | 29,201 |
| Insurance | 19,000 | 19,699 | 15,203 |
| Appeal boards | 30,000 | 19,546 | 20,183 |
| Office | 26,500 | 16,033 | 11,876 |
| Promotion and publications | 15,000 | 13,829 | 25,143 |
| Other | 16,720 | 10,259 | 7,807 |
| Repairs and maintenance | 10,280 | 4,237 | 10,740 |
| | 2,673,500 | 2,517,764 | 2,400,250 |
| **Excess (deficiency) of revenue over expenditures** | $ (106,500) | $ 293,041 | $ (483,035) |

ALBERTA INSURANCE COUNCIL

## STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2004

| | 2004 | 2003 |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operating activities** | | |
| Excess (deficiency) of revenue over expenditures | $ 293,041 | $ (483,035) |
| Items not affecting cash | | |
| Amortization of property and equipment | 118,033 | 94,925 |
| Amortization of program development costs | 105,202 | 75,531 |
| Amortization of deferred tenant inducement | (4,730) | (4,730) |
| | 511,546 | (317,309) |
| Net changes in non-cash working capital items | | |
| Decrease in accounts receivable | 2,920 | 66,760 |
| Increase in prepaid expenses | (10,352) | (11,400) |
| Increase in accounts payable and accrued liabilities | 12,512 | 18,035 |
| Increase in deferred license revenue | 110,872 | 162,700 |
| | 627,498 | (81,214) |
| **Investing activities** | | |
| Purchase of property and equipment | (109,240) | (149,464) |
| (Repayment of) proceeds from capital lease | (4,500) | 9,000 |
| Expenditures on deferred program and examination development - net of recovery | (35,636) | (37,386) |
| Decrease in recoverable program development costs | 53,104 | 28,562 |
| | (96,272) | (149,288) |
| **Increase (decrease) in cash** | 531,226 | (230,502) |
| **Cash - Beginning of year** | 1,590,102 | 1,820,604 |
| **Cash - End of year** | $ 2,121,328 | $ 1,590,102 |
| **Supplementary information** | | |
| Interest received | $ 48,603 | $ 52,449 |

ALBERTA INSURANCE COUNCIL

# NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2004

## NOTE 1 AUTHORITY AND PURPOSE

The Alberta Insurance Council (the "Council") operates under the authority of the Insurance Act, Chapter I-3, Revised Statutes of Alberta 2000, as amended. As a not-for-profit organization under the Income Tax Act, the Council is not subject to either federal or provincial income taxes.

The Council provides administration services to the Life Insurance, General Insurance and Insurance Adjusters Councils. These Councils are responsible for enforcing the provisions of the Insurance Act and Regulations for their segments of the insurance industry.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgement. Actual results could differ from those estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

**Revenue Recognition**

License and assessment fees are recognized as revenue on a straight-line basis over the term of the license and assessment. Examination fees are recognized at the time the related exam is held. Continuing education ("CE") course approval fees are recognized upon course submission. CE provider fees are recognized on a calendar year basis. License and assessment fees received but not yet recognized as revenue are recorded as deferred license and assessment fee revenue.

**Recoverable Program Development Costs**

Costs incurred by the Council as a committee member of the Canadian Insurance Regulatory Organization ("CISRO") on behalf of other jurisdictions are expected to be recovered from those jurisdictions over the next two years.

**Deferred Program and Examination Development Costs**

**a) Deferred program development costs**

Costs which have been incurred by the Council as a committee member of CISRO for the development of the Life License Qualification Program (the "LLQP" program) are deferred. Upon program implementation on January 1, 2003, these costs are amortized on a straight-line basis over a period of three years.

ALBERTA INSURANCE COUNCIL

**NOTE 2 (continued)**

**b) Deferred examination development costs**

Costs which have been incurred by the Council for the development of LLQP examination questions have been deferred. These costs, net of recoveries, will be amortized on a straight-line basis over a period of three years upon completion of the development and testing of the questions.

**Property and Equipment and Amortization**

Property and equipment is recorded at cost and is amortized over their estimated useful lives on a straight-line basis as follows:

| | |
|---|---|
| Leasehold improvements | Term of the lease |
| Furniture and office equipment under capital lease | 10 years |
| Furniture and office equipment | 10 years |
| Computer equipment | 3 years |
| Computer software | 3 years |
| Telephone equipment | 5 years |

**Deferred Tenant Inducement**

Deferred tenant inducement in the amount of $9,067 (2003 - $13,797) is recorded at amortized cost and is amortized over the eight-year lease term into occupancy expense.

**Contributed Services**

The work of the Council is dependent on the voluntary services of members. The value of donated services is not recognized in these financial statements.

## NOTE 3 CASH

Included in cash is an amount of $1,934,127 (2003 - $1,433,843) invested in the Consolidated Cash Investment Trust Fund ("CCITF"). The CCITF is managed by the Government of Alberta with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital.

ALBERTA INSURANCE COUNCIL

## NOTE 4 DEFERRED PROGRAM EXAMINATION DEVELOPMENT COSTS

| | | | 2004 | 2003 |
|---|---|---|---|---|
| | Cost | Accumulated amortization | Net | Net |
| Travel | $ 94,742 | $ 63,162 | $ 31,580 | $ 52,777 |
| Professional fees | 176,359 | 117,571 | 58,788 | 98,286 |
| Exam development | 46,014 | - | 46,014 | 54,885 |
| | $ 317,115 | $ 180,733 | $ 136,382 | $ 205,948 |

Based on a review of recoverable program development costs, it has been determined that amounts previously thought to be collectible are not recoverable. Of those amounts, $44,507 has been reclassified to deferred program development costs and has been amortized over the period remaining for the amounts previously deferred. A non-cash charge of $6,145 has been recorded to write off the remaining uncollectible amounts.

## NOTE 5 PROPERTY AND EQUIPMENT

| | | | 2004 | 2003 |
|---|---|---|---|---|
| | Cost | Accumulated amortization | Net | Net |
| Leasehold improvements | $ 70,399 | $ 60,071 | $ 10,328 | $ 14,651 |
| Furniture and office equipment under capital lease | 9,075 | 1,210 | 7,865 | 8,771 |
| Furniture and office equipment | 150,178 | 113,490 | 36,688 | 44,761 |
| Computer equipment | 202,608 | 152,032 | 50,576 | 63,515 |
| Computer software | 350,056 | 236,076 | 113,980 | 91,800 |
| Telephone equipment | 38,864 | 32,949 | 5,915 | 10,647 |
| | $ 821,180 | $ 595,828 | $ 225,352 | $ 234,145 |

ALBERTA INSURANCE COUNCIL

## NOTE 6 LEASE COMMITMENTS

The Council is committed to operating leases payments for business premises and equipment as follows:

| | |
|---|---|
| 2005 | $ 92,095 |
| 2006 | 88,151 |
| 2007 | 44,767 |
| 2008 | 44,641 |
| 2009 | 29,509 |

The Council is committed to capital lease payments for equipment in 2005 in the amount of $4,537.

## NOTE 7 FINANCIAL INSTRUMENTS

The Council's financial instruments comprise cash, accounts receivable, recoverable program development costs, accounts payable and accrued liabilities and obligation under capital lease. The carrying value of these financial instruments approximate fair value. The Council is potentially subject to concentrations of interest rate risk principally with its investment in the Consolidated Cash Investment Trust Fund. Credit risk is negligible as the majority of revenue is from license and assessment fees, which are billed in advance. There are no unrecorded financial instruments.

## NOTE 8 COMPARATIVE FIGURES

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

ALBERTA INSURANCE COUNCIL

## SCHEDULE OF SALARIES AND BENEFITS — Schedule 1

For the Year Ended December 31, 2004

**Per diem Payments of Council Members**

The following amounts are included in council meetings expenses:

| | 2004 # | 2004 Total | 2003 # | 2003 Total |
|---|---|---|---|---|
| Councils [a] | | | | |
| Chairs | 6 | $ 40,575 | 6 | $ 41,907 |
| Council Members | 24 | 45,825 | 26 | 52,000 |
| Total | 30 | $ 86,400 | 32 | $ 93,907 |

(a) This includes the Alberta Insurance Council, the Life Insurance Council, the General Insurance Council, the Insurance Adjusters Council and the Audit Committe.

**Salaries and Benefits**

| | 2004 # | Salary[b] | Benefits[c] | 2004 Total | 2003 # | 2003 Total |
|---|---|---|---|---|---|---|
| Chief Executive Officer (formerly General Manager) | 1 | $ 147,237 | $ 33,598 | $ 180,835 | 1 | $ 162,887 |
| Assistant General Manager | 1 | 122,941 | 32,629 | 155,570 | 1 | 139,577 |
| Full-time staff [d] | 19 | 845,456 | 165,761 | 1,011,217 | 17 | 944,797 |
| Part-time staff | 6 | 61,072 | 8,235 | 69,307 | 3 | 52,559 |
| Total | 27 | $1,176,706 | $240,223 | $1,416,929 | 22 | $1,299,820 |

(b) Salary includes regular base pay, bonuses and overtime.

(c) Employer's share of all employee benefits and contributions or payments made on behalf of employees including group RRSP, health care, dental coverage, group life insurance, long and short-term disability plans and vacation pay. Accrued vacation pay was $18,035 (2003 - $22,034).

(d) Full-time staff consists of all individuals working 29 hours or more per week. Average annual salary and benefits was $61,754 (2003 - $55,440).

# ALBERTA PENSIONS ADMINISTRATION CORPORATION

## Financial Statements
YEAR ENDED DECEMBER 31, 2004

AUDITOR GENERAL
Alberta

# AUDITOR'S REPORT

**To the Shareholder of Alberta Pensions Administration Corporation**

I have audited the balance sheet of the Alberta Pensions Administration Corporation as at December 31, 2004 and the statements of income and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
April 12, 2005

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## BALANCE SHEET

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash | $ 54 | $ 98 |
| Accounts receivable | 106 | 12 |
| Prepaid expenses | 103 | 120 |
| Due from pension plans | 4,509 | 3,224 |
| Property and equipment (Note 5) | 8,664 | 8,040 |
| | $ 13,436 | $ 11,494 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | |
| Liabilities | | |
| Accounts payable and accrued liabilities | $ 1,984 | $ 1,376 |
| Accrued salaries and benefits | 797 | 502 |
| Accrued vacation pay | 606 | 719 |
| Deferred lease inducement | 52 | 70 |
| Capital lease obligation (Note 13) | 1,333 | 787 |
| Deferred capital contributions [Note 3(b)] | 8,664 | 8,040 |
| | 13,436 | 11,494 |
| Shareholder's equity | | |
| Share capital (Note 6) | - | - |
| | $ 13,436 | $ 11,494 |

*The accompanying notes are part of these financial statements.*

On behalf of the Board:

Jack H. McMahon
Chairman of the Board

R.C. (Rick) Milner
Audit Committee Chairman

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## STATEMENT OF INCOME

Year Ended December 31, 2004 *(thousands)*

| | Budget 2004 | Actual 2004 | Actual 2003 |
|---|---|---|---|
| **Revenue** | | | |
| Service revenue (Note 7) | $ 25,669 | $ 24,381 | $ 24,713 |
| Miscellaneous revenue | 65 | 52 | 75 |
| Total revenue | 25,734 | 24,433 | 24,788 |
| **Operating costs** | | | |
| Salaries and benefits | 13,161 | 13,481 | 11,765 |
| Amortization | 2,692 | 2,612 | 2,113 |
| Contract services | 2,654 | 2,255 | 1,717 |
| Materials and supplies | 3,210 | 2,242 | 5,745 |
| Rent | 620 | 706 | 538 |
| Data processing | 506 | 414 | 753 |
| Operating costs before plan specific costs | 22,843 | 21,710 | 22,631 |
| Plan specific costs (Note 10) | 2,891 | 2,723 | 2,157 |
| Total operating costs | 25,734 | 24,433 | 24,788 |
| **Net income** | $ - | $ - | $ - |

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## STATEMENT OF CASH FLOWS

Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ - | $ - |
| Items not requiring cash | | |
| Amortization | 2,612 | 2,113 |
| Capital contributions recognized | (2,612) | (2,113) |
| | - | - |
| Changes in non-cash working capital (Note 8) | (572) | (805) |
| | (572) | (805) |
| **Investing activities** | | |
| Acquisition of property and equipment | (3,237) | (3,235) |
| **Financing activities** | | |
| (Decrease)/increase in deferred lease inducement | (18) | 70 |
| Increase in capital lease obligation | 546 | 787 |
| Capital contributions received | 3,237 | 3,235 |
| | 3,765 | 4,092 |
| **(Decrease)/ increase in cash for the year** | (44) | 52 |
| **Cash at beginning of year** | 98 | 46 |
| **Cash at end of year** | $ 54 | $ 98 |

ALBERTA PENSIONS ADMINISTRATION CORPORATION

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 AUTHORITY

The Alberta Pensions Administration Corporation (the Corporation) was incorporated under the *Business Corporation Act,* Chapter B-9, Revised Statutes of Alberta, 2000. The issued share of the Corporation is owned by the Government of Alberta, and accordingly the Corporation is exempt from income taxes.

## NOTE 2 NATURE OF OPERATIONS

The Minister of Finance of Alberta, operating under the authority of the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000, and the *Financial Administration Act*, Chapter F-12, RSA 2000, is responsible for administering the following pension plans:

Local Authorities Pension Plan

Public Service Pension Plan

Management Employees Pension Plan

Special Forces Pension Plan

Public Service Management (Closed Membership) Pension Plan

Members of the Legislative Assembly Pension Plan

Provincial Judges and Masters In Chambers (Registered) Pension Plan

Supplementary Retirement Plan for Public Service Managers

Provincial Judges and Masters In Chambers (Unregistered) Pension Plan

All administrative services required by the pension plans are provided by the Corporation pursuant to the Administrative Services Agreement with the Minister through to December 31, 2005. These services include the collection of contributions, payment of benefits and refunds, communication to stakeholders, pension plan board support services and other services specifically requested by individual pension boards.

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Property and Equipment

Property and equipment is recorded at cost and is amortized on a straight-line basis over the estimated useful life of the asset as follows:

| | |
|---|---|
| Computer equipment | 2 to 3 years |
| Computer software | 2 to 3 years |
| Furniture and equipment | 5 years |
| Telephone system | 3 years |
| Leasehold improvements | Lease period |
| APEX business system | 3 to 5 years |

Property and equipment under construction, including software development projects, is not amortized until completion and implementation.

### (b) Recognition of Deferred Capital Contributions

Financing obtained from the public sector pension plan funds to acquire property and equipment is recorded as deferred capital contributions. These amounts are recognized as revenue on the same basis as the acquired property and equipment is amortized.

## NOTE 4 VALUATION OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

The fair values of accounts receivable, accounts payable and accrued liabilities are estimated to approximate their carrying values.

## NOTE 5 PROPERTY AND EQUIPMENT

*(thousands)*

| | Cost | Accumulated Amortization | 2004 Net Book Value | 2003 Net Book Value |
|---|---|---|---|---|
| APEX business system | $ 9,620 | $ 3,590 | $ 6,030 | $ 6,689 |
| Computer equipment | 2,211 | 1,578 | 633 | 734 |
| Leasehold improvements | 1,414 | 130 | 1,284 | 247 |
| Furniture and equipment | 1,000 | 482 | 518 | 145 |
| Computer software | 921 | 722 | 199 | 225 |
| Telephone system | 43 | 43 | - | - |
| | $ 15,209 | $ 6,545 | $ 8,664 | $ 8,040 |

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## NOTE 6 SHARE CAPITAL

| | 2004 | 2003 |
|---|---|---|
| Authorized | | |
| Unlimited number of common shares | | |
| Unlimited number of preferred shares | | |
| Issued | | |
| 1 common share, for cash (Note 1) | $ 1 | $ 1 |

## NOTE 7 SERVICE REVENUE

The Corporation charged each plan with its respective share of the Corporation's operating and plan specific costs based on the allocation formula approved by the Minister of Finance.

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Public Sector Pension Plans | | |
| Local Authorities Pension Plan | $ 14,655 | $ 14,827 |
| Public Service Pension Plan | 6,283 | 6,568 |
| Management Employees Pension Plan | 1,427 | 1,364 |
| Special Forces Pension Plan | 1,106 | 976 |
| Public Service Management (Closed Membership) Pension Plan | 344 | 392 |
| Provincial Judges and Masters in Chambers (Registered) Pension Plan | 63 | 76 |
| Members of the Legislative Assembly Pension Plan | 57 | 74 |
| Supplementary Retirement Pension Plans | | |
| Supplementary Retirement Plan for Public Service Managers | 378 | 368 |
| Provincial Judges and Masters in Chambers (Unregistered) Pension Plan | 68 | 68 |
| | $ 24,381 | $ 24,713 |

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## NOTE 8 CHANGES IN NON-CASH WORKING CAPITAL

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Changes in non-cash working capital consist of the following: | | |
| Increase in accounts receivable | $ (94) | $ (7) |
| Decrease/(increase) in prepaid expenses | 17 | (118) |
| (Increase)/decrease in due from pension plans | (1,285) | 701 |
| Increase/(decrease) in accounts payable and accrued liabilities | 608 | (1,663) |
| Increase in accrued salaries and benefits | 295 | 160 |
| (Decrease)/increase in accrued vacation pay | (113) | 122 |
| | $ (572) | $ (805) |

## NOTE 9 RELATED PARTY TRANSACTIONS

*(thousands)*

| | | 2004 | 2003 |
|---|---|---|---|
| The Corporation received the following services at amounts which approximate market from: | | | |
| Alberta Corporate Service Centre | Data processing and postage | $ 524 | $ 794 |
| Alberta Finance | Accounting and administrative | 28 | 25 |
| Alberta Infrastructure | Parking rental | 10 | 16 |

The Corporation also provided services to the Public Sector Pension Plans as disclosed in Notes 7 and 10.

## NOTE 10 PLAN SPECIFIC COSTS

The Corporation makes certain payments on behalf of the pension plan boards. These costs, which are incurred directly by the pension plan boards, and which the Corporation does not control, are as follows:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Contract services | $ 1,508 | $ 1,376 |
| Salaries and benefits | 636 | 360 |
| Materials and supplies | 389 | 269 |
| Remuneration for Pension Plan Boards | 184 | 136 |
| Data processing | 6 | 16 |
| | $ 2,723 | $ 2,157 |

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## NOTE 11 SALARIES AND BENEFITS DISCLOSURE

*(thousands)*

| | | | | 2004 | 2003 |
|---|---|---|---|---|---|
| | Base Salary [a] | Other Cash Benefits [b] | Other Non-Cash Benefits [c] | Total | Total |
| Corporation Board Chair[d] | $ - | $ 31 | $ 2 | $ 33 | $ 31 |
| Corporation Board Members[d] | - | 92 | 11 | 103 | 77 |
| President and Chief Executive Officer[e] | 146 | 32 | 28 | 206 | 243 |
| Corporate Officers: | | | | | |
| Chief Operating Officer and Corporate Secretary[f] | 132 | 26 | 28 | 186 | 191 |
| Chief Information Officer | 115 | 20 | 26 | 161 | 136 |
| Chief Administrative Officer[g] | 119 | 77 | 37 | 233 | 174 |
| Executive: | | | | | |
| Executive Director Operation | 115 | 14 | 24 | 153 | 153 |

a) Base salary includes pensionable base pay.
b) Other cash benefits includes incentive pay, lump sum payments, vacation payouts and honoraria.
c) Employer's share of all employee benefits and contributions or payments made on behalf of employees including pension, health care, dental coverage, group life insurance, long-term disability, WCB premiums, professional memberships and tuition fees.
d) Remuneration paid to the Chair and four board members is classified as contract services and is paid in accordance with the fee structure approved by the Minister of Finance.
e) Automobile provided, no dollar amount included in other non-cash benefits figures.
f) Other cash benefits include vacation payouts to the Chief Operating Officer and Corporate Secretary $4,748 (2003: $nil).
g) The Chief Administrative Officer (CAO) position was held by two individuals during the year, with an overlap of one month for transition purposes. The former CAO was paid all holiday pay owing ($62,729) upon retiring.

## NOTE 12 PENSIONS

The Corporation participates in the Management Employees Pension Plan, Public Service Pension Plan and Supplementary Retirement Plan for Public Service Managers which are multiemployer pension plans. The expense for these pension plans is equivalent to the annual contributions of $891,923 for the year ended December 31, 2004 (2003: $609,853).

ALBERTA PENSIONS ADMINISTRATION CORPORATION

## NOTE 13 CAPITAL LEASES OBLIGATION

The Corporation is committed under capital leases for computer equipment for the periods extending to 2006. Future minimum lease payments are as follows:

*(thousands)*

| | |
|---|---|
| 2005 | $ 941 |
| 2006 | 440 |
| Total minimum lease payments | 1,381 |
| Less amount representing maintenance costs | 48 |
| Capital lease obligation | 1,333 |
| Current portion | 893 |
| Long term portion | $ 440 |

## NOTE 14 COMMITMENTS

The Corporation has entered into agreements with minimum annual commitments for office space and automobile as follows:

*(thousands)*

| | |
|---|---|
| 2005 | $ 718 |
| 2006 | 717 |
| 2007 | 703 |
| 2008 | 675 |
| 2009 | 479 |

## NOTE 15 COMPARATIVE FIGURES

Certain 2003 figures have been reclassified to conform with the 2004 presentation.

## NOTE 16 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Corporation’s Board of Directors.

# ALBERTA SECURITIES COMMISSION

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Members of the Alberta Securities Commission**

I have audited the balance sheet of the Alberta Securities Commission as at March 31, 2005 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta — Fred J. Dunn, FCA

July 4, 2005 — Auditor General

ALBERTA SECURITIES COMMISSION

# BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Current | | |
| Cash (Note 4) | $ 3,185 | $ 1,599 |
| Funds held for others (Note 9) | 9 | 295 |
| Accounts and advances receivable | 77 | 57 |
| Lease inducement receivable | 389 | 69 |
| Prepaid expense | 102 | 42 |
| | 3,762 | 2,062 |
| Non-current | | |
| Restricted cash (Note 3) | 829 | 932 |
| Investments (Note 4) | 19,790 | 17,258 |
| Capital assets (Note 6) | 2,124 | 2,218 |
| Lease inducement receivable and lease deposit | 132 | 521 |
| | 22,875 | 20,929 |
| Total assets | $ 26,637 | $ 22,991 |
| **Liabilities and retained earnings** | | |
| Current | | |
| Funds held for others (Note 9) | $ 9 | $ 295 |
| Accounts payable and accrued liabilities | 1,602 | 970 |
| Accrued vacation and benefit liabilities | 667 | 666 |
| Lease inducement (Note 7) | 167 | 170 |
| | 2,445 | 2,101 |
| Non-current | | |
| Lease inducement (Note 7) | 618 | 785 |
| Accrued benefit liability (Note 8) | 1,713 | 1,267 |
| Total liabilities | 4,776 | 4,153 |
| Retained earnings (Note 3) | 21,861 | 18,838 |
| Total liabilities and retained earnings | $ 26,637 | $ 22,991 |

*The accompanying notes and schedules are part of these financial statements.*

Approved by the members:

William S. Rice
Chair

Dennis A. Anderson, FCA
Member

ALBERTA SECURITIES COMMISSION

## STATEMENT OF INCOME AND RETAINED EARNINGS

For the Year Ended March 31, 2005 *(thousands)*

| | Budget (Note 12) | 2005 Actual | 2004 Actual |
|---|---|---|---|
| **Revenue** | | | |
| Fees (Note 10) | $ 18,260 | $ 18,887 | $ 16,406 |
| Investment income (Note 5) | 830 | 1,568 | 1,698 |
| Settlement cost recoveries | - | 187 | 248 |
| | 19,090 | 20,642 | 18,352 |
| **Expense** | | | |
| Salaries and benefits | 12,696 | 12,191 | 11,363 |
| Professional services | 2,164 | 1,961 | 2,179 |
| Administration | 1,952 | 1,476 | 1,620 |
| Premises | 1,343 | 1,347 | 1,315 |
| Amortization | 560 | 541 | 519 |
| Investor education (Note 3) | 573 | 360 | 514 |
| Total expense | 19,288 | 17,876 | 17,510 |
| Budget contingency | 1,790 | - | - |
| Income (loss) from operations | (1,988) | 2,766 | 842 |
| Administrative penalties revenue (Note 3) | - | 257 | 215 |
| **Net income (loss)** | (1,988) | 3,023 | 1,057 |
| **Opening retained earnings** | | 18,838 | 17,781 |
| **Closing retained earnings** (Note 3) | | $ 21,861 | $ 18,838 |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA SECURITIES COMMISSION

## STATEMENT OF CASH FLOWS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts from fees | $ 18,887 | $ 16,628 |
| Cash receipts from settlement cost recoveries | 187 | 248 |
| Cash paid to and on behalf of employees | (11,753) | (10,979) |
| Cash paid to suppliers for goods and services | (5,050) | (5,899) |
| Edmonton office closure | - | (130) |
| Investment income | 1,568 | 1,698 |
| Cash advanced to MICA project (Note 9) | (53) | (110) |
| Administrative penalties | 257 | 215 |
| Cash flows from operating activities | 4,043 | 1,671 |
| **Cash flows from investing activities** | | |
| Lease inducement received | 199 | 400 |
| Decrease (increase) in restricted cash | 103 | (146) |
| Cash used for capital assets (1) | (348) | (1,096) |
| Cash used for investments | (2,532) | (1,938) |
| Cash returned from CSA for NRD funding | 121 | 236 |
| Cash used in investing activities | (2,457) | (2,544) |
| **Increase (decrease) in cash** | 1,586 | (873) |
| **Opening cash** | 1,599 | 2,472 |
| **Closing cash** | $ 3,185 | $ 1,599 |
| Supplemental cash flow information | | |
| (1) Additions to capital assets | (450) | (1,012) |
| Proceeds on disposal | 3 | 2 |
| Increases (decreases) in capital asset liabilities | 99 | (86) |
| | $ (348) | $ (1,096) |

*The accompanying notes and schedules are part of these financial statements.*

ALBERTA SECURITIES COMMISSION

# NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended March 31, 2005 *(thousands)*

## NOTE 1 NATURE OF OPERATIONS

The Alberta Securities Commission is a Provincial Corporation operating under the *Securities Act* (Alberta). The business of the Commission is the regulation of the Alberta capital market, including the administration of the Act, the Securities Regulation and the Alberta Securities Commission Rules.

The mission of the Commission is to foster a fair and efficient capital market in Alberta and confidence in that market. In carrying out its mission, the Commission strives to balance the needs of investors for adequate protection with the needs of industry to access capital necessary for continued economic growth.

The Commission, as an Alberta Provincial Corporation, is exempt from income tax.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles.

The accounting policies of significance to the Commission are as follows:

**(a) Portfolio Investments**

Portfolio investments are recorded at cost. Realized gains and losses on disposal of these investments are included in the determination of net operating results for the year. Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

**(b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability.

Gains and losses arising as a result of disposal of investments are included in the determination of investment income.

Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts are recorded at fair value. Unrealized gains and losses on these derivative contracts are recognized in income.

ALBERTA SECURITIES COMMISSION

**NOTE 2** **(continued)**

**(c) Valuation of Financial Assets and Liabilities**

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act.

The fair values of cash, receivables, payables and accrued liabilities are estimated to approximate their book values.

The methods used to determine the fair values of portfolio investments and derivative contracts are explained in the following paragraphs:

Public fixed-income securities and equities are valued at the year-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, equity index futures contracts and forward foreign exchange contracts. The value of derivative contracts is included in the fair value of the Commission's investment in the Canadian Dollar Public Bond Pool and Domestic Passive Equity Pooled Fund (see Note 4). The fair value of derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bonds index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.

(iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

(iv) Forward foreign exchange contracts and equity index futures contracts are valued based on quoted market prices.

ALBERTA SECURITIES COMMISSION

**NOTE 2 (continued)**

**(d) Capital Assets**

Capital assets are recorded at cost.

Assets are amortized on a straight-line basis over their estimated useful lives as follows:

| | |
|---|---|
| Computer equipment and software | 3 years |
| Furniture and equipment | 10 years |
| Leasehold improvements | remaining lease term to March 2011 |

**(e) Fee Revenue Recognition**

Fees are recognized when earned which is upon cash receipt.

**(f) Employee Future Benefits**

The Commission participates in the Public Service Pension Plan, a multi-employer defined benefit pension plan, with other government entities. This plan is accounted for as a defined contribution plan as the Commission has insufficient information to apply defined benefit plan accounting to this pension plan. Pension costs included in these financial statements comprise the cost of employer contributions for current service of employees during the year and additional employer contributions for the service relating to prior years.

The Commission maintains a Supplemental Pension Plan (the Plan) for certain designated executives of the Commission. The cost of the pension is actuarially determined using the projected benefit method pro-rated on services and management's best estimate of economic assumptions. Past service costs and actuarial losses arising from assumption changes are amortized on a straight-line basis over the average remaining service period of employees active at the date of commencement of the plan. Gains and losses arising from employee changes are recognized in the year of change. The average remaining service period of active employees of the Plan is five years.

The Commission also maintains a plan whereby it makes Registered Retirement Savings Plan contributions on behalf of certain employees of the Commission. The contributions are calculated based on a fixed percentage of the employee's salary to a maximum of the Registered Retirement Savings Plan contribution limit as specified in the *Income Tax Act*. The expense included in these financial statements represents the current contributions made on behalf of the employees.

**(g) Lease Inducement**

Cash payments received as lease inducements are deferred and amortized on a straight-line basis over the lease term.

ALBERTA SECURITIES COMMISSION

**NOTE 2 (continued)**

**(h) Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**(i) Restricted Cash**

The *Alberta Securities Act* permits the use of revenues received by the Commission from Administrative Penalties for certain operating expenditures that educate investors and enhance the knowledge of the securities market operation.

## NOTE 3 RESTRICTED CASH AND RETAINED EARNINGS

Retained earnings include $829 ($932 in 2004) of restricted cash, as described in Note 2(i). The restricted cash decrease represents administrative penalty receipts, interest income and net acccounting conference income during the year of $257 less eligible investor education expenses of $360. Accounting conference net income of $8 ($6 in 2004) is net of $64 ($57 in 2004) of expenses.

## NOTE 4 CASH AND INVESTMENTS

**a) Summary**

| | | | 2005 | | | 2004 |
|---|---|---|---|---|---|---|
| | Cost | Fair Value | % | Cost | Fair Value | % |
| Cash | | | | | | |
| Deposit in the CCITF | $ 3,185 | $ 3,185 | | $ 1,599 | $ 1,599 | |
| Investments | | | | | | |
| Deposit in the CCITF | $ 56 | $ 56 | 0.3 | $ 54 | $ 54 | 0.3 |
| Fixed-income securities (Schedule B) | 14,757 | 14,709 | 72.8 | 12,386 | 12,442 | 69.7 |
| Canadian equities (Schedule C) | 4,977 | 5,432 | 26.9 | 4,818 | 5,364 | 30.0 |
| | $ 19,790 | $ 20,198 | 100.0 | $ 17,258 | $ 17,860 | 100.0 |

Cash consists of demand deposits in the Consolidated Cash Investment Trust Fund that is managed by the Ministry of Finance to provide competitive interest income while maintaining maximum security and liquidity of depositors' capital. The Fund is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. The average effective yield for securities held by the fund at March 31, 2005 was 2.8% (2.1% in 2004) per annum.

The Commission's investments are held in pooled investment funds established and managed by the Ministry of Finance. Investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of units. As at March 31, 2005, the Commission's percentage ownership, at market, in pooled investment funds is 0.17% or less.

ALBERTA SECURITIES COMMISSION

**NOTE 4 (continued)**

**(b) Investment Risk Management**

The value of investments is exposed to credit and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of interest rate risk and market risk. Interest rate risk relates to the possibility that the investments will change in value due to fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn an optimal financial return at an acceptable level of risk, the Commission has established an investment policy, which is reviewed annually. Risk is reduced through asset class diversification, diversification within each asset class and quality and duration constraints on fixed-income instruments. Controls are in place respecting the use of derivatives. While the Commission reports the results of these risk management initiatives in its accounts, the Commission is a passive third party recipient of these transactions and does not engage directly in derivative or swap contracting.

**(c) Derivative Contracts**

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Ministry of Finance uses derivative contracts within the investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount.

An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index.

For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount.

Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies.

A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security.

Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

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**NOTE 4 (continued)**

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of the specified equity index.

There are underlying securities supporting all swaps. Leveraging is not allowed.

The following is a summary of the Commission's proportionate share of the notional amount and fair value of swap contracts issued by pooled funds as at March 31, 2005.

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount (a) | Net Fair Value (b) | Notional Amount (a) | Net Fair Value (b) |
| Equity index swap contracts | 83% | 17% | - | $ 2,067 | $ 52 | $ 1,679 | $ (5) |
| Cross-currency interest rate swaps | 9% | 21% | 70% | 1,651 | (46) | 1,196 | (178) |
| Interest rate swap contracts | 39% | 53% | 8% | 868 | (24) | 1,054 | (48) |
| Bond index swap contracts | 100% | - | - | 286 | 2 | 176 | 4 |
| Credit default swap contracts | 29% | 10% | 61% | 260 | 3 | 81 | (1) |
| Forward foreign exchange contracts | 100% | - | - | 91 | 7 | - | - |
| Equity index futures contracts | - | - | - | - | - | 1 | - |
| | | | | $ 5,223 | $ (6) | $ 4,187 | $ (228) |

(a) Current credit exposure is represented by the replacement cost of all outstanding contracts in favourable position (positive fair value).

(b) The method of determining the fair value of derivative contracts is described in note 2(c).

## NOTE 5 NET INVESTMENT INCOME

| | 2005 | 2004 |
|---|---|---|
| Interest | $ 766 | $ 768 |
| Net realized gain on investments | 535 | 542 |
| Derivative income | 214 | 333 |
| Dividends | 53 | 55 |
| | $ 1,568 | $ 1,698 |

## NOTE 6 CAPITAL ASSETS

| | Cost | Accumulated Amortization | 2005 Net Book Value | 2004 Net Book Value |
|---|---|---|---|---|
| Computer equipment and software | $ 1,946 | $ 1,391 | $ 555 | $ 484 |
| Furniture and equipment | 511 | 252 | 259 | 291 |
| Leasehold improvements | 2,378 | 1,068 | 1,310 | 1,443 |
| | $ 4,835 | $ 2,711 | $ 2,124 | $ 2,218 |

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## NOTE 7 LEASE INDUCEMENTS

Lease inducement balances include:

| Lease | Term | Current Inducement | Future Inducement |
|---|---|---|---|
| Calgary, old | 10 years, ending 2006 | $ 40 | $ - |
| Calgary, new | 8 years, ending March 2011 | 124 | 618 |
| Calgary sublease | 3 years, ending October 2005 | 3 | - |
| | | $ 167 | $ 618 |

## NOTE 8 ACCRUED BENEFIT LIABILITY AND PENSION EXPENSE

The accrued benefit liability includes:

| | 2005 | 2004 |
|---|---|---|
| Retirement Plan | $ 190 | $ 182 |
| Supplemental Pension Plan | 1,523 | 1,085 |
| | $ 1,713 | $ 1,267 |

The following pension expense for the plans is recorded in the Statement of Income under salaries and benefits.

| | 2005 | 2004 |
|---|---|---|
| Public Service Pension Plan | $ 277 | $ 231 |
| Registered Retirement Savings Plan | 287 | 270 |
| Retirement Plan | 29 | 2 |
| Supplemental Pension Plan | 438 | 286 |
| | $ 1,031 | $ 789 |

**(a) Public Service Pension Plan**

The Commission participates in the Public Service Pension Plan (the PSPP).

At December 31, 2004 the PSPP reported a deficiency of $450,068 and in 2003 a deficiency of $584,213.

ALBERTA SECURITIES COMMISSION

**NOTE 8 (continued)**

**(b) Registered Retirement Savings Plan**

The Commission makes contributions on behalf of employees who do not participate in the PSPP to employee Registered Retirement Savings Plans.

**(c) Retirement Plan**

The Commission has a retirement plan for an executive who is now retired. The provisions of the retirement plan were established pursuant to a written agreement. The retirement plan provides pension benefits based on a fixed schedule of payments over a fifteen year period ending in August 2017. Accrued benefits are payable on death. The retirement plan is not pre-funded and the benefits are paid ($21 in 2005, $21 in 2004) from the assets of the Commission as they come due.

**(d) Supplemental Pension Plan**

The Commission has a Supplemental Pension Plan (the Plan) for certain designated executives of the Commission. The provisions of the Plan were established pursuant to a written agreement with each designated executive.

The Plan provides pension benefits to the designated executives that are defined by reference to earnings in excess of the limit (increased from $86 to $92 effective January 1, 2004 and $100 January 1, 2005) imposed by the *Income Tax Act* on registered pension arrangements.

Pension benefits from the Plan are payable on or after attainment of age 55 and are equal to 1.75% of highest average pensionable earnings (average over five years) for each year of service with the Commission. Members of the Plan become vested in the benefits of the plan after two years of service. Accrued benefits are also payable on early retirement (with reductions), death or termination of employment of the designated executive.

The Plan is not pre-funded and the benefits will be paid as they come due from the assets of the Commission.

Actuarial valuations of the Plan are undertaken every three years and the most recent, at April 1, 2004, was performed by an independent actuary. An extrapolation of the 2004 valuation was made by the actuary for March 31, 2005 through March 31, 2008, as at April 1, 2005. The next valuation is scheduled for April 1, 2007.

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**NOTE 8 (continued)**

The results of the actuarial valuation and extrapolation and management's cost estimates as they apply to the Plan are summarized below:

| **Balance Sheet at March 31** | **2005** | **2004** |
|---|---|---|
| Market value of assets | $ - | $ - |
| Accrued benefit obligation | 1,895 | 1,391 |
| Unfunded obligation | 1,895 | 1,391 |
| Unamortized transitional obligation | (176) | (202) |
| Unamortized actuarial loss | (320) | (104) |
| Employee change liability, management estimate | 124 | - |
| Accrued benefit liability | $ 1,523 | $ 1,085 |
| **Accrued Benefit Obligation** | | |
| Accrued benefit obligation at beginning of the year | $1,391 | $1,033 |
| Service cost | 205 | 197 |
| Interest cost | 97 | 64 |
| Net Actuarial loss, less benefits paid of $33 ($- in 2004) | 202 | 97 |
| Accrued benefit obligation at end of the year | $ 1,895 | $ 1,391 |
| **Pension Expense** | | |
| The pension expense for the Plan is as follows: | | |
| Service cost | $ 205 | $ 197 |
| Interest cost | 97 | 64 |
| Amortization of transitional obligation | 26 | 25 |
| Recognized actuarial losses during year | 110 | - |
| Pension expense | $ 438 | $ 286 |

**Actuarial Assumptions for Actuarial Valuation of the Plan**

The assumptions used in the 2005 actuarial extrapolation of the Plan are summarized below. The 2004 assumptions are based on the 2004 actuarial valuation of the Plan. The discount rate was established in accordance with the yield on long term corporate bonds and applies to both the accrued benefit obligation and benefit costs. Other economic assumptions were established as management's best estimate in collaboration with the actuary. Demographic assumptions were selected by the actuary based on best estimate of the future experience of the plans.

| | **2005** | **2004** |
|---|---|---|
| Discount rate | 5.80% | 6.10% |
| Rate of inflation | 2.65% | 2.35% |
| Salary increases | 3.65% | 3.35% |
| Remaining service life (EARSL) | 5 years | 10 years |

ALBERTA SECURITIES COMMISSION

## NOTE 9 FUNDS HELD FOR OTHERS

The Commission holds, in a separate bank account, $9 ($295 in 2004) in cash for participants in the Market Integrity Computer Analysis (MICA) system upgrade project. The Commission has recorded a total project expense of $164 ($53 in 2004) and has a remaining commitment of $6. Funds are disbursed as payments are made for approved expenditures. Expenditures, if any, in excess of the amounts held for others and the Commission's contribution, require further participant approval and contribution. The MICA project will assist participants in the analysis of trading activities.

## NOTE 10 FEES

| | 2005 | 2004 |
|---|---|---|
| Distribution of Securities | $ 9,172 | $ 6,879 |
| Registrations | 6,109 | 6,715 |
| Annual Financial Statements | 3,300 | 2,504 |
| Other | 6 | 3 |
| Orders (Applications) | 300 | 305 |
| Total | $ 18,887 | $ 16,406 |

## NOTE 11 COMMITMENTS AND CONTINGENCIES

Set out below are details of commitments to organizations outside the Commission and contingencies from guarantees and legal actions. Any losses arising from the settlement of contingencies are treated as expenses in the year of settlement.

**(a) Commitments**

Commitments arising from contractual obligations associated primarily with the eight year lease of premises, the remaining MICA commitment and three year average rental of office equipment at March 31, 2005 amounted to $10,450 ($11,692 in 2004). These commitments become expenses of the Commission when the terms of the contracts are met.

| | |
|---|---|
| 2005-06 | $ 1,732 |
| 2006-07 | 1,756 |
| 2007-08 | 1,804 |
| 2008-09 | 1,729 |
| 2009-10 | 1,717 |
| Thereafter | 1,712 |
| Total | $ 10,450 |

ALBERTA SECURITIES COMMISSION

**NOTE 11 (continued)**

**Canadian Securities Administrators (CSA)** - The Commission also agreed to share, based on an agreed upon cost sharing formula, the costs incurred for the maintenance of the CSA Secretariat (formerly Project Office), and any third party costs incurred in the development of harmonized rules, regulations and policies. The CSA Secretariat was established to assist in the development and harmonization of rules, regulations and policies across Canada.

**SEDAR operations agreement** - CDS INC. (CDS) operates the SEDAR electronic filing and payment system on behalf of the CSA under an August 1, 2004 agreement. The Alberta Securities Commission, as one of the agreement signatories, commits to pay CDS 11.7% of any shortfall from SEDAR system operating costs that exceed revenues. Alternatively, CDS must pay to CSA SEDAR revenues in excess of system operating costs ("surplus"). The surplus is not divisible; the CSA owns it as a group. CDS has paid $5,783 to the OSC, in trust, to December 31, 2004. This amount represents the SEDAR surpluses to July 31, 2004. Subsequent to March 31, 2005 a further $160 was paid to OSC for the period ending October 31, 2004. The principal CSA administrators, including the Commission, have agreed that SEDAR surplus amounts can only be used to offset any shortfall in SEDAR revenues, develop or enhance the SEDAR and SEDI systems, and reduce SEDAR fees.

**(b) Legal Actions**

The Commission is involved in various legal proceedings arising from its operations and regulatory activities. Management considers the chance of liability under these legal proceedings not to be determinable and accordingly an estimate of any contingent loss cannot be made.

## NOTE 12 BUDGET

The Minister of Finance approved budget includes fee increases of $2,719 and a contingency expense provision of $1,916 less a vacancy reserve of $126. A budget contingency provision of up to ten percent of planned expenditures for unplanned expenses and revenue shortfalls is provided for in the Memorandum of Understanding between the Minister and the Commission. Commission members must approve any expenditure that is applied to the budget contingency expense provision. Subsequent to budget approval, the Commission members approved and the Finance Minister agreed to a revised budget including, a deferral of the fee increase beyond 2005, revenue increases of $500 arising from accelerated financial statement filings and related fees, following a change in the filing rule and elimination of the contingency expense provision of $1,916. Members also approved a further expenditure (which was applied against the contingency amount) of $135 for an enforcement staff position and professional fees for a compensation survey and a financial reporting controls documentation project. Actual revenues and expenses resulting from these budget changes are recorded in their respective accounts.

ALBERTA SECURITIES COMMISSION

## NOTE 13 RELATED PARTY TRANSACTIONS

The Commission is related through common ownership to all provincial government ministries, agencies, boards, commissions and crown corporations. The Commission conducted all transactions with these entities as though they were unrelated parties and recorded transaction costs of $60 ($66 in 2004).

## NOTE 14 COMPARATIVES

Comparative 2004 professional services expense are increased by CSA project costs of $226 and are reduced by $445 of investor education costs that have been reclassified to conform to their 2005 presentation.

Comparative 2004 administration costs include other, materials and supplies, travel, member fees and telephone and communication costs that have been reclassified to conform to their 2005 presentation.

ALBERTA SECURITIES COMMISSION

# SCHEDULES TO THE FINANCIAL STATEMENTS

## SCHEDULE OF SALARIES AND BENEFITS — Schedule A

For the year ended March 31, 2005 *(dollars)*

| | Base Salary (1) | Other Cash Benefits (2) | Other Non-cash Benefits (3) | 2005 Total | 2004 Total (4) |
|---|---|---|---|---|---|
| Chair, Securities Commission (5) | $ 412,000 | $ 58,400 | $ 227,986 | $ 698,386 | $ 559,632 |
| Vice Chair, Securities Commission (5) | 211,000 | 25,000 | 64,888 | 300,888 | 284,495 |
| Vice Chair, Securities Commission (5) | 191,500 | 25,000 | 37,019 | 253,519 | 241,016 |
| Members (part-time) | 367,848 | - | - | 367,848 | 288,487 |
| Executives | | | | | |
| Executive Director | 235,000 | 33,500 | 71,211 | 339,711 | 316,530 |
| Director, Legal/Policy | 182,000 | 19,000 | 41,797 | 242,797 | 231,908 |
| Director, Capital Markets | 176,500 | 10,000 | 43,478 | 229,978 | 220,310 |
| Director, Enforcement (6) | 180,000 | 25,000 | 41,004 | 246,004 | 235,750 |
| Director, Administrative Services | 160,400 | - | 37,393 | 197,793 | 201,561 |
| Chief Accountant | 166,500 | 19,000 | 21,608 | 207,108 | 197,190 |
| General Counsel | 176,000 | 30,000 | 21,082 | 227,082 | 201,238 |

(1) Base salary includes regular base pay and honoraria.

(2) Other cash benefits include bonuses, lump sum payments, Chair and Executive Director's automobile allowance and vacation payouts.

(3) Employer's share of all employee benefits and contributions or payments made on behalf of employees including pensions, registered retirement savings plan contributions, health care, dental coverage, out of country medical benefits, group life insurance, accidental disability and dismemberment insurance, long and short term disablity, professional memberships, tuition, club memberships, worker's compensation and Supplemental Pension Plan.

(4) 2004 Comparative figures are restated to include Supplemental Pension Plan accruals.

(5) The Chair and Vice Chairs are full time Commission Members. The Chair’s 2005 compensation includes $100,000 of incremental Supplemental Pension Plan accrual.

(6) The previous Director of Enforcement resigned October 10, 2003 and his vacation payout is included in 2004.

ALBERTA SECURITIES COMMISSION

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule B

March 31, 2005 *(thousands)*

| | Commission's share 2005 Cost | Commission's share 2005 Fair Value | Commission's share 2004 Cost | Commission's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposit in the Consolidated Cash Investment Trust Fund** | $ 90 | $ 90 | $ 19 | $ 19 |
| **Public fixed-income securities** | | | | |
| Government of Canada direct and guaranteed | 4,417 | 4,350 | 3,000 | 2,964 |
| Provincial: | | | | |
| Alberta, direct and guaranteed | 8 | 9 | 9 | 9 |
| Other, direct and guaranteed | 3,259 | 3,419 | 2,800 | 2,968 |
| Municipal | 181 | 186 | 164 | 169 |
| Corporate | 5,323 | 5,196 | 5,082 | 5,018 |
| **Private fixed-income securities** | | | | |
| Corporate | 1,373 | 1,353 | 1,343 | 1,326 |
| | 14,651 | 14,603 | 12,417 | 12,473 |
| Accounts receivable and accrued investment income | 175 | 175 | 145 | 145 |
| Accounts payable and accrued liabilities | (69) | (69) | (176) | (176) |
| | 106 | 106 | (31) | (31) |
| | $ 14,757 | $ 14,709 | $ 12,386 | $ 12,442 |

(a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.34% per annum (4.20% per annum in 2004) and the following term structure based on principal amounts:

| | 2005 % | 2004 % |
|---|---|---|
| under 1 year | 3 | 2 |
| 1 to 5 years | 38 | 40 |
| 5 to 10 years | 31 | 30 |
| 10 to 20 years | 12 | 10 |
| over 20 years | 16 | 18 |
| | 100 | 100 |

(b) The Commission's fixed income securities are held in the Canadian Dollar Public Bond Pool (the Pool). The Pool is managed by the Ministry of Finance with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

ALBERTA SECURITIES COMMISSION

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule C**

March 31, 2005 *(thousands)*

| | Commission's share 2005 Cost | Commission's share 2005 Fair Value | Commission's share 2004 Cost | Commission's share 2004 Fair Value |
|---|---|---|---|---|
| **Deposits and short-term securities** | $ 38 | $ 38 | $ 34 | $ 34 |
| **Public equities (a) (b)** | | | | |
| Financial | 1,588 | 1,741 | 1,497 | 1,723 |
| Energy | 907 | 1,117 | 639 | 783 |
| Materials | 725 | 780 | 823 | 907 |
| Consumer discretionary | 387 | 374 | 387 | 371 |
| Telecommunication services | 343 | 356 | 268 | 256 |
| Information technology | 321 | 314 | 365 | 428 |
| Industrials | 260 | 287 | 376 | 398 |
| Consumer staples | 203 | 230 | 187 | 209 |
| Health care | 98 | 82 | 117 | 116 |
| Utilities | 72 | 79 | 167 | 181 |
| | 4,904 | 5,360 | 4,826 | 5,372 |
| Receivable from sale of investments and accrued investment income | 71 | 71 | 21 | 21 |
| Accounts payable and accrued liabilities | (36) | (36) | (63) | (63) |
| | 35 | 35 | (42) | (42) |
| | $ 4,977 | $ 5,433 | $ 4,818 | $ 5,364 |

(a) The Commission's effective net investment in Canadian public equities includes the fair value of deposits and floating rate notes totaling $2,067 ($1,680 in 2004) which are used as underlying securities to support the notional amount of Canadian equity index swap contracts.

(b) The industrial classifications are those used by the Toronto Stock Exchange indices.

ALBERTA SECURITIES COMMISSION

## Schedule C (continued)

(c) The Commission's investments in Canadian equities, as determined by the Ministry of Finance, are held in the following pooled funds administered by the Ministry of Finance.

| | 2005 Cost | 2005 Fair Value | 2004 Cost | 2004 Fair Value |
|---|---|---|---|---|
| Domestic Passive Equity Pooled Fund (i) | $ 2,927 | $ 2,978 | $ 2,338 | $ 2,391 |
| Canadian Pooled Equity Fund (ii) | 1,427 | 1,788 | 1,172 | 1,517 |
| External Managers Canadian Large Cap Equity Pool (iii) | 623 | 667 | 1,308 | 1,456 |
| | $ 4,977 | $ 5,433 | $ 4,818 | $ 5,364 |

(i) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Total Return Index. The portfolio is comprised of publicly traded equities in Canadian corporations similar in weights to the S&P/TSX Composite Index. To enhance investment returns with no substantial increase in risks, the pool uses structured investments such as domestic equity index swaps. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the Pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in equities and bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.

(ii) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection and sector rotation.

(iii) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capital focus.

ALBERTA SECURITIES COMMISSION

## SCHEDULE OF INVESTMENT RETURNS

**Schedule D**

The Commission uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Commission over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the return of pools with other pools or indices.

Investment return percentages for the Commission are as follows:

| | One Year Return | | | | | 5 Year Compound Annualized Return |
|---|---|---|---|---|---|---|
| **Time-weighted rates of return** | **2005** | **2004** | **2003** | **2002** | **2001** | |
| **Short-term fixed income** | **3.7** | **4.2** | **2.9** | **4.0** | **5.8** | **4.1** |
| *Scotia Capital 91-day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *5.7* | *3.5* |
| **Long-term fixed income** | **5.4** | **11.7** | **9.5** | **5.7** | **9.4** | **8.3** |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *8.7* | *7.7* |
| **Canadian equities** | **15.0** | **36.6** | **(17.5)** | **n/a** | **n/a** | **n/a** |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *n/a* | *n/a* | *n/a* |
| **Overall** | **7.8** | **17.8** | **2.3** | **4.3** | **8.6** | **8.0** |

# THE ALBERTA GOVERNMENT TELEPHONES COMMISSION

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Member of The Alberta Government Telephones Commission**

I have audited the balance sheet of The Alberta Government Telephones Commission as at December 31, 2004 and the statement of revenue, expense and retained earnings for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
May 20, 2005

Fred J. Dunn, FCA
Auditor General

THE ALBERTA GOVERNMENT TELEPHONES COMMISSION

## BALANCE SHEET

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash and temporary investments (Note 3) | $ - | $ 45,850 |
| **LIABILITIES AND EQUITY** | | |
| Accounts payable and accrued liabilities | $ - | $ 80 |
| Due to the Province of Alberta (Note 4) | - | 45,770 |
| | - | 45,850 |
| Retained earnings | - | - |
| | $ - | $ 45,850 |

*The accompanying notes are part of these financial statements.*

On behalf of the Commission:

Rod Matheson, Chairman and Sole Commission Member

THE ALBERTA GOVERNMENT TELEPHONES COMMISSION

## STATEMENT OF REVENUE, EXPENSE AND RETAINED EARNINGS

Year Ended December 31, 2004 *(thousands)*

| | Budget | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **Revenue** | | | |
| Interest on deposits | $ - | $ 297 | $ 983 |
| Foreign exchange gain on income taxes | - | - | 3,120 |
| | - | 297 | 4,103 |
| **Expense** | | | |
| Foreign exchange loss on notes | - | - | 5,415 |
| Interest and other | - | - | 62 |
| | - | - | 5,477 |
| **Gain on valuation adjustment (Note 2(c))** | - | - | 20,818 |
| **Excess of revenue over expense for the year** | - | 297 | 19,444 |
| **Retained earnings at beginning of year** | - | - | - |
| **Transfer to the Province of Alberta** | - | (297) | (19,444) |
| **Retained earnings at end of year** | $ - | $ - | $ - |

THE ALBERTA GOVERNMENT TELEPHONES COMMISSION

# NOTES TO THE FINANCIAL STATEMENTS

Year Ended December 31, 2004

## NOTE 1 AUTHORITY

The Alberta Government Telephones Commission (the Commission) operates under the authority of the *Telecommunications Act*, Chapter T-3.5, Statutes of Alberta 1988, as amended.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Financial Statement Presentation

A cash flow statement is not provided due to the limited nature of the Commission's operations. All information about the Commission's cash flows is contained within the financial statements.

### (b) Valuation of Assets and Liabilities

Due to the short-term nature of cash and cash equivalents, interest and accounts receivable, and accounts payable and accrued liabilities, the carrying value approximates fair value.

### (c) Foreign Currency

Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date. Foreign currency transactions are translated at the average exchange rate prevailing during the year.

## NOTE 3 CASH AND TEMPORARY INVESTMENTS

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Bank deposits | $ - | $ 135 |
| CCITF account | - | 45,715 |
| | $ - | $ 45,850 |

The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

THE ALBERTA GOVERNMENT TELEPHONES COMMISSION

## NOTE 4 DUE TO THE PROVINCE OF ALBERTA

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Balance at beginning of year | $ 45,770 | $ 26,326 |
| Excess of revenue over expense of the Commission | 297 | 19,444 |
| Funds repaid during the year | (46,067) | - |
| Balance at end of year | $ - | $ 45,770 |

Pursuant to section 15 of the *Telecommunications Act*, the amount due to the Province of Alberta can be paid, with the approval of the Lieutenant Governor in Council, with money that the Commission determines to be surplus. O.C. 70/2004 dated February 25, 2004, authorized the transfer.

During 2004, the Commission transferred its remaining assets to the province with the approval of the Lieutenant Governor in Council and now has no assets or liabilities. Accordingly, the Commission is being wound up, see Note 8.

## NOTE 5 FEES AND BENEFITS

The Commission did not pay any fees or benefits to the Sole Commission Member. The Commission has no employees.

## NOTE 6 BUDGET

The 2004 budget was published in the 2004-05 Government and Lottery Fund Estimates at page 159.

## NOTE 7 RELATED PARTY TRANSACTIONS

Other than interest earned from the Consolidated Cash Investment Trust Fund, there were no other related party transactions during the year.

## NOTE 8 FUTURE OPERATIONS

All the remaining assets of the Commission have been transferred to the Province of Alberta and the Commission will be wound up through an Act of the Legislature.

# ALBERTA TREASURY BRANCHES

## Consolidated Financial Statements

YEAR ENDED MARCH 31, 2005

AUDITOR GENERAL
*Alberta*

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the consolidated balance sheet of Alberta Treasury Branches as at March 31, 2005, and the consolidated statement of income and changes in equity and the consolidated statement of cash flows for the year then ended. These consolidated financial statements are the responsibility of Alberta Treasury Branches' management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Alberta Treasury Branches as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta — Fred J. Dunn, FCA

May 10, 2005 — Auditor General

ALBERTA TREASURY BRANCHES

# CONSOLIDATED BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Cash resources** (Note 4) | | |
| Cash and items in transit | $ 26,279 | $ 101,281 |
| Interest bearing deposits with financial institutions | 927,244 | 956,727 |
| | 953,523 | 1,058,008 |
| **Securities** (Note 5) | 932,511 | 854,997 |
| Loans (Notes 6 and 7) | | |
| Residential mortgage | 5,818,780 | 5,378,595 |
| Personal | 2,091,904 | 1,857,028 |
| Credit card | 288,772 | 270,098 |
| Business | 5,106,655 | 4,818,228 |
| Allowance for loan losses | (168,194) | (192,896) |
| | 13,137,917 | 12,131,053 |
| **Other** | | |
| Premises and equipment (Note 8) | 110,067 | 93,016 |
| Other assets (Notes 9) | 247,214 | 168,736 |
| | 357,281 | 261,752 |
| | $ 15,381,232 | $ 14,305,810 |
| **LIABILITIES AND EQUITY** | | |
| **Deposits** (Note 10) | | |
| Personal | $ 8,003,418 | $ 7,815,239 |
| Business and other | 5,836,614 | 5,219,881 |
| | 13,840,032 | 13,035,120 |
| **Other liabilities** (Note 11) | 325,207 | 262,313 |
| **Subordinated debentures** (Note 12) | 65,719 | 45,416 |
| **Equity** | 1,150,274 | 962,961 |
| | $ 15,381,232 | $ 14,305,810 |

*The accompanying notes are an integral part of these consolidated financial statements.*

Approved by the Board:

R. Triffo, Chairman of the Board

B. Hesje, Chairman of the Audit Committee

ALBERTA TREASURY BRANCHES

## CONSOLIDATED STATEMENT OF INCOME AND CHANGES IN EQUITY

For the years ended March 31 *(thousands)*

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Interest income** | | | |
| Loans | $ 657,838 | $ 695,106 | $ 657,374 |
| Securities | 20,188 | 22,268 | 18,613 |
| Deposits with financial institutions | 21,857 | 23,227 | 21,537 |
| | 699,883 | 740,601 | 697,524 |
| **Interest expense** | | | |
| Deposits | 297,791 | 340,627 | 330,896 |
| Subordinated debentures | 3,346 | 2,690 | 2,468 |
| | 301,137 | 343,317 | 333,364 |
| **Net interest income** | 398,746 | 397,284 | 364,160 |
| **Other income** | | | |
| Service charges | 54,320 | 53,213 | 49,699 |
| Credit fees | 29,788 | 28,216 | 26,520 |
| Other | 21,543 | 10,001 | 10,423 |
| Card fees | 18,336 | 15,636 | 13,892 |
| Investor Services | 8,632 | 3,276 | 1,594 |
| Foreign exchange | 6,689 | 5,930 | 5,314 |
| | 139,308 | 116,272 | 107,442 |
| **Total operating revenues** | 538,054 | 513,556 | 471,602 |
| **Provision for (recovery of) credit losses** (Note 7) | (14,594) | 15,859 | (43,211) |
| **Non-interest expenses** | | | |
| Salaries and employee benefits (Notes 13 and 16) | 189,410 | 168,028 | 160,160 |
| Other | 63,758 | 51,872 | 52,943 |
| Communications and electronic processing | 58,094 | 55,199 | 55,884 |
| Premises and equipment, including amortization | 54,073 | 50,574 | 46,922 |
| | 365,335 | 325,673 | 315,909 |
| **Net income** | 187,313 | 172,024 | 198,904 |
| **Equity at beginning of year** | 962,961 | 790,937 | 592,033 |
| **Equity at end of year** | $ 1,150,274 | $ 962,961 | $ 790,937 |

*The accompanying notes are an integral part of these consolidated financial statements.*

ALBERTA TREASURY BRANCHES

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the years ended March 31 *(thousands)*

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income | $ 187,313 | $ 172,024 | $ 198,904 |
| Adjustments to determine net cash flows: | | | |
| Provision for (recovery of) credit losses | (14,594) | 15,859 | (43,211) |
| Amortization | 25,862 | 24,676 | 20,107 |
| Net changes in accrued interest receivable and payable | (10,263) | 9,138 | 12,604 |
| Other items, net | (5,321) | 13,692 | (49,779) |
| Net cash provided by operating activities | 182,997 | 235,389 | 138,625 |
| **Cash flows from financing activities** | | | |
| Net change in deposits | 804,912 | 938,209 | 671,701 |
| Payments on maturation of subordinated debentures | (7,519) | - | - |
| Proceeds on issuance of subordinated debentures | 27,822 | - | 15,234 |
| Net cash provided by financing activities | 825,215 | 938,209 | 686,935 |
| **Cash flows from investing activities** | | | |
| Net change in interest bearing deposits with financial institutions | 29,483 | (377,120) | 172,662 |
| Purchase of investment securities | (7,910,221) | (7,802,340) | (6,653,500) |
| Maturity of investment securities | 7,832,707 | 7,526,193 | 6,882,443 |
| Net change in loans | (992,270) | (455,430) | (1,247,708) |
| Net purchases of premises and equipment | (42,913) | (36,370) | (26,768) |
| Net cash provided by (used in) investing activities | (1,083,214) | (1,145,067) | (872,871) |
| **Net (decrease) increase in cash and cash equivalents** | (75,002) | 28,531 | (47,311) |
| **Cash and cash equivalents at beginning of year** | 101,281 | 72,750 | 120,061 |
| **Cash and cash equivalents at end of year** | $ 26,279 | $ 101,281 | $ 72,750 |
| Supplementary cash flow information: | | | |
| Amount of interest paid during the year | $ 307,942 | $ 341,462 | $ 335,260 |

*The accompanying notes are an integral part of these consolidated financial statements.*

ALBERTA TREASURY BRANCHES

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2005 *(thousands)*

## NOTE 1 AUTHORITY

Alberta Treasury Branches ("ATB") is an Agent of the Crown in right of Alberta and operates under the authority of the *Alberta Treasury Branches Act,* Revised Statutes of Alberta, 2000, chapter A-37. Under the Act, ATB was established as a provincial Crown corporation governed by a Board of Directors appointed by the Lieutenant Governor in Council. ATB is exempt from Canadian federal and Alberta provincial income taxes.

ATB's primary business is providing financial services within Alberta.

## NOTE 2 BASIS OF PRESENTATION

Management has prepared these Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles (or "GAAP").

**Use of estimates**

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of balance sheet assets and liabilities and disclosure of contingent assets and liabilities as at the balance sheet date as well as the reported amounts of revenues and expenses during the reported period. Actual results could differ significantly from these estimates and the impact of any such differences will be recorded in future periods.

The most significant amounts and disclosures where ATB must make estimates include the allowances for credit losses, amortization of premises and equipment, assumptions underlying the accounting for employee future benefit obligations and the fair value of financial instruments, including derivative financial instruments.

**Basis of consolidation**

These Consolidated Financial Statements include the assets, liabilities and results of operations and cash flows of ATB and its subsidiaries. All inter-company transactions and balances have been eliminated.

The following wholly owned subsidiaries are incorporated under the Business Corporation Act (Alberta) and were established for the purpose of offering investor services:

- ATB Investment Services Inc. established October 3, 1997;
- ATB Investment Management Inc. established August 21, 2002; and
- ATB Securities Inc. established February 6, 2003.

**Translation of foreign currencies**

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Operating revenues and expenses related to foreign currency transactions are translated using the average exchange rate for the year. Realized and unrealized gains and losses arising from these translations are included in "Other income" in the Consolidated Statement of Income.

ALBERTA TREASURY BRANCHES

**NOTE 2 (continued)**

**Other significant accounting policies**

Other significant accounting policies followed in the preparation of these Consolidated Financial Statements are disclosed throughout the following notes along with the related financial disclosures.

**Comparative amounts**

Certain comparative amounts have been reclassified where necessary to conform to the presentation adopted in the current year.

## NOTE 3 CHANGES IN ACCOUNTING POLICIES

ATB has adopted the following new accounting policies issued by Canadian standard setters in the current year:

**Hedging relationships**

See Note 14 for details.

**Sources of generally accepted accounting principles**

As of December 31, 2004, ATB prospectively adopted the Canadian Institute of Chartered Accountants' (or "CICA's") new accounting standard Section 1100, "Generally Accepted Accounting Principles". This standard provides additional guidance on sources to consult when selecting accounting policies and determining appropriate disclosures on matters not covered explicitly in the primary sources of Canadian accounting standards.

Following the adoption of this new accounting standard, the following change in accounting policy was applied prospectively:

- Balances payable to other financial institutions arising from the clearing system's processing of items that do not clear overnight, previously presented as a component of "Cash and items in transit" under "Cash resources" are now presented as "Cheques & other items in transit" under "Other liabilities".

**Future accounting policy changes**

No accounting policy changes have been identified that are expected to impact ATB's financial reporting for the fiscal year ending March 31, 2006.

## NOTE 4 CASH RESOURCES

Cash consists of cash on hand, bank notes and coins. Cash resources also include deposits with the Bank of Canada, deposits with other financial institutions and any net amounts receivable for cheques and other items in the clearing systems that settle overnight.

Deposits with the Bank of Canada and financial institutions are recorded at cost, as are items in transit (which generally represent clearing amounts settling overnight with other financial institutions). Interest income on interest bearing deposits is recorded on an accrual basis.

ALBERTA TREASURY BRANCHES

**NOTE 4 (continued)**

The Investor Services subsidiaries held restricted cash balances (clients' cash held in trust) amounting to $10,947 as at March 31, 2005 (2004: $11,353).

## NOTE 5 SECURITIES

Debt securities are recognized at unamortized acquisition cost and any premiums or discounts are amortized using the effective yield method over the period to maturity. All debt securities held are purchased with the intention to hold them to maturity, or until market conditions render alternative investments more attractive. Equity securities are recognized at acquisition cost, as ATB does not exercise any significant influence over the investee companies.

Dividend and interest income as well as the amortization of premiums and discounts are recorded in "Interest income" in the Consolidated Statement of Income. Gains and losses realized on the disposal of securities, calculated using the average cost method, and any provisions for loss in value that is considered to be other than temporary, are also included in "Interest income" in the period of disposal or impairment.

The carrying value of securities, by remaining term to maturity, is as follows:

| | Within one year | Within 1-5 years | 2005 Total carrying value | 2004 Total carrying value |
|---|---|---|---|---|
| Issued or guaranteed by the Canadian federal government | $ 13,659 | $ - | $ 13,659 | $ 13,679 |
| Corporate debt | 819,852 | 99,000 | 918,852 | 837,916 |
| Corporate equity | - | - | - | 3,402 |
| | $ 833,511 | $ 99,000 | $ 932,511 | $ 854,997 |

The total carrying value of securities in the preceding schedule includes securities denominated in U.S. funds totaling $51,813 (2004: $9,985).

As described in Note 15, ATB has pledged certain securities as at March 31, 2005 having total carrying value of $215,100 (2004: $234,200).

ALBERTA TREASURY BRANCHES

## NOTE 6 LOANS

Loans are stated net of any unearned fee income and net of specific and general allowances for credit losses. Interest income is recorded on an accrual basis, except for impaired loans.

**Impaired loans**

Impaired loans, except for credit cards, are classified as such when there is no longer reasonable assurance as to the timely collection of principal and interest, or when principal or interest payments are 90 days past due. Consumer credit card loans are classified as impaired and written off when payments become 180 days past due. Business and agricultural credit card loans that become past due for three consecutive billing cycles (or approximately 90 days) are removed from the credit card portfolio and transferred into the applicable impaired loan category.

When a loan is classified as impaired, the carrying amount of the loan is reduced to its estimated net realizable amount by writing off all or part of the loan or by taking a specific allowance for credit losses and interest income on the loan ceases to be accrued. No cash received on an impaired loan is recorded as interest income until such time as any prior write-offs or specific allowances and external legal fees have been recovered and all past due principal has been paid. Impaired loans are returned to performing status when there is reasonable assurance of the timely collection of all principal and interest, all arrears have been collected, legal fees recovered and allowances for loan losses have been reversed.

Foreclosed assets held for sale in settlement of an impaired loan are measured at estimated fair value at the date of foreclosure and are presented as a component of "Loans" in the Consolidated Balance Sheet.

**Loan fees**

Loan and commitment fees in excess of $50 are deferred and recognized as "Other income" in the Consolidated Statement of Income over the term of the loan or over the commitment period, as appropriate. The unrecognized portion of loan and commitment fees is netted against "Loans" in the Consolidated Balance Sheet.

Loans consist of the following:

| | Gross loans | Specific allowances | General allowances | 2005 Net carrying value | 2004 Net carrying value |
|---|---|---|---|---|---|
| Residential mortgage | $ 5,818,780 | $ 2,165 | $ 3,184 | $ 5,813,431 | $ 5,370,928 |
| Personal | 2,091,904 | 2,234 | 33,540 | 2,056,130 | 1,804,850 |
| Credit card | 288,772 | - | 19,027 | 269,745 | 270,098 |
| Agricultural | 1,283,707 | 7,573 | 19,577 | 1,256,557 | 1,288,653 |
| Independent business | 1,758,443 | 9,349 | 35,883 | 1,713,211 | 1,623,797 |
| Commercial | 2,064,505 | 6,044 | 29,618 | 2,028,843 | 1,772,727 |
| | $13,306,111 | $ 27,365 | $ 140,829 | $13,137,917 | $12,131,053 |

The total net carrying value of loans above include loans denominated in U.S. funds totalling $55,242 (2004: $56,267).

ALBERTA TREASURY BRANCHES

**NOTE 6 (continued)**

Impaired loans (included in the preceding schedule) consist of the following:

| | Gross impaired loans | Specific allowance | 2005 Net carrying value | 2004 Net carrying value |
|---|---|---|---|---|
| Residential mortgage | $ 26,503 | $ 2,165 | $ 24,338 | $ 29,511 |
| Personal | 8,214 | 2,234 | 5,980 | 7,281 |
| Credit card | - | - | - | - |
| Agricultural | 29,101 | 7,573 | 21,528 | 22,153 |
| Independent business | 18,466 | 9,349 | 9,117 | 13,014 |
| Commercial | 7,338 | 6,044 | 1,294 | 1,705 |
| | $ 89,622 | $ 27,365 | $ 62,257 | $ 73,664 |

**Concentration of credit risk**

ATB faces credit risk from the risk of loss due to borrowers failing to meet their financial obligations. The loan portfolio represents the largest single source of credit risk to ATB, but credit risk also arises from off-balance sheet transactions such as over-the-counter derivatives and other credit instruments (see Notes 14 and 15, respectively).

Concentrations of credit risk exist where a significant number of credit consumers are located in the same geographic region, engage in similar activities or have similar economic characteristics. Their ability to meet their contractual obligations to ATB would be similarly affected by changes in economic, political or other conditions.

ATB is inherently exposed to significant concentrations of credit risk as our customers are all participants in the Alberta economy, which, in past decades, has shown strong growth and occasional sharp declines. ATB manages its credit risk through diversification of its credit portfolio by limiting concentrations to single borrowers, industries and geographical regions of Alberta.

As at March 31, 2005 and 2004, no single industry segment represents more than 24.16% of total gross business loans and no single borrower represents more than 0.62% of the total gross loan portfolio.

## NOTE 7 ALLOWANCE FOR CREDIT LOSSES

The allowance for credit losses is maintained at a level management considers adequate to absorb credit-related losses for all items in its credit portfolio. The allowance relates primarily to loans and other on-balance sheet items but also provides for any credit risk relating to off-balance sheet items such as derivative financial instruments recorded using hedge accounting (see Note 14) and loan guarantees and letters of credit (see Note 15).

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**NOTE 7 (continued)**

The allowance for credit losses consists of specific allowances for impaired loans and general allowances for credit risks. It is presented in the Consolidated Balance Sheet as either a reduction of the related loan balance or, for amounts provided to cover potential losses from off-balance sheet items and any portion of loan-related allowances in excess of the loan balance, included in "Other liabilities". The allowance is increased by the "Provision for credit losses" that represents ATB's net credit loss experience for the year and is recorded in the Consolidated Statement of Income. The allowance is decreased by the amount of any provision related to loans written-off and is net of any recoveries of previously recognized provisions.

**Specific allowances**

The specific allowances on non-consumer impaired loans (including credit card balances) are established on an item-by-item basis to reduce the carrying value of the impaired loans to the amount expected to be recovered. Various methods are used to determine the net recoverable value of impaired loans including the discounted value of estimated future cash flows, the fair value of any underlying security discounted to the amount recoverable in the event of realization, or the observable market value for the loan. The specific allowance on consumer loans is calculated using a formula based on recent loss experience. No specific allowance is provided for impaired consumer credit card loans, as balances are written off if payment has not been received within 180 days though collection efforts may still continue. Any change in the amount expected to be recovered on an impaired loan is reflected in the "Provision for credit losses" in the Consolidated Statement of Income.

**General allowance**

A general allowance for credit losses is established to provide for impairments in the credit portfolio as at the balance sheet date that cannot be specifically identified on an item-by-item basis and therefore have not been considered in the establishment of specific allowances.

The level of the general allowance is initially determined by applying expected loss factors to the loan and off-balance sheet credit portfolios. For consumer balances (including personal and other instalment loans, residential mortgages and personal credit cards), expected losses are determined at the product portfolio level, based on credit rating-based loss ratios, expected default rates and historical loss experiences. For commercial balances (including business loans, business credit cards and credit instrument balances, adjusted for expected utilization), expected losses are determined at the borrower category level by reference to internal risk ratings, expected default rates by risk rating and historical loss experiences. The consumer and commercial components of the general allowances thus determined are then adjusted to reflect management's best judgement concerning possible model and estimation risks and the strength of the Alberta economy and the overall state of the business cycle.

The general allowance is reassessed quarterly and will normally fluctuate as a result of changes in credit portfolio levels, composition and risk profile. Trends in probability of loss, severity of loss and eventual exposure on default are also considered, as is management's assessment of other factors that may affect the losses inherent in the credit portfolio such as business mix, economic and credit market conditions and trends.

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**NOTE 7 (continued)**

**Special general allowance**

In the event certain industry sectors experience specific changes in economic conditions or adverse events that are considered to increase credit risk, an additional special general allowance may be established. Such allowances are established to provide for losses inherent in the credit portfolio that have not been specifically identified and that the general allowance is not considered sufficient to provide for. The amount of any special general allowance is reassessed quarterly using expected loss methodologies that consider the probability of further changes in the conditions or adverse event that gave rise to the initial establishment of the allowance. The follow-on probability of default, potential loss given default and the level of expected recoveries, if any, are also considered.

The continuity of the allowances for credit losses is as follows :

| | Specific 2005 | 2004 | 2003 | General 2005 | 2004 | 2003 | Total 2005 | 2004 | 2003 |
|---|---|---|---|---|---|---|---|---|---|
| Balance at beginning of year | $39,935 | $35,012 | $89,588 | $ 157,719 | $ 146,311 | $ 138,855 | $ 197,654 | $181,323 | $228,443 |
| Write-offs | (16,213) | (12,394) | (29,459) | - | - | - | (16,213) | (12,394) | (29,459) |
| Recoveries | 6,129 | 12,866 | 25,550 | - | - | - | 6,129 | 12,866 | 25,550 |
| Provision for (recovery of) credit losses | 2,296 | 4,451 | (50,667) | (16,890) | 11,408 | 7,456 | (14,594) | 15,859 | (43,211) |
| Balance at end of year | $32,147 | $39,935 | $35,012 | $ 140,829 | $ 157,719 | $ 146,311 | $ 172,976 | $197,654 | $181,323 |
| Less: Allowance for cost of credit recovery included in other liabilities | | | | | | | 4,782 | 4,758 | 6,590 |
| Allowance for loan losses | | | | | | | $ 168,194 | $192,896 | $174,733 |

The specific allowance for credit losses as at March 31 consists of the following :

| | 2005 | 2004 |
|---|---|---|
| Specific loan losses | $ 27,365 | $ 35,177 |
| Credit recovery costs | 4,782 | 4,758 |
| | $ 32,147 | $ 39,935 |

The general allowance for credit losses presented above includes a special allowance of $8.0 million for losses related to Bovine Spongiform Encephalopathy (or "BSE") (2004: $17.5 million). This special general allowance was first established as at June 30, 2003.

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## NOTE 8 PREMISES AND EQUIPMENT

Premises and equipment are carried at cost less accumulated amortization except for land, which is carried at cost. Premises, computer equipment and software, other equipment and leasehold improvements are amortized on a straight-line basis over their estimated useful lives. The estimated useful lives for the various asset classes are as follows:

| | |
|---|---|
| · Premises | Up to 20 years |
| · Computer equipment and software | 3 to 5 years |
| · Other equipment | 5 to 10 years |
| · Leases hold improvements | Lease term plus first renewal period, to a maximum of 10 years |

| | Cost | Accumulated amortization | 2005 Net carrying value | 2004 Net carrying value |
|---|---|---|---|---|
| Land | $ 7,618 | $ - | $ 7,618 | $ 7,382 |
| Buildings | 70,098 | 51,274 | 18,824 | 14,755 |
| Computer equipment and software | 101,239 | 58,429 | 42,810 | 26,824 |
| Other equipment | 32,759 | 22,025 | 10,734 | 10,938 |
| Leasehold improvements | 73,940 | 43,859 | 30,081 | 33,117 |
| | $ 285,654 | $ 175,587 | $ 110,067 | $ 93,016 |

Amortization expense charged to the Consolidated Statement of Income for the year ended March 31, 2005, in respect of the above assets was $25,862 (2004: $24,676; 2003: $20,107).

Gains and losses on the disposal of assets are recorded in the Consolidated Statement of Income in the year of disposal. When events or changes in circumstances indicate that the carrying value of premises and equipment may not be recoverable, we assess whether the asset may have been impaired. The net carrying value of any such impaired assets are written-down to their estimated fair value. $4,525 of such impairment write-downs were recognized during the year ended March 31, 2005 (2004: $ 4,728; 2003: $0). These amounts are recorded in "Premises and equipment, including amortization" in the Consolidated Statement of Income.

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## NOTE 9 OTHER ASSETS

Other assets are comprised as follows:

| | 2005 | 2004 |
|---|---|---|
| Accrued interest receivable | $ 126,272 | $ 122,814 |
| Cheques & other items in transit | 70,000 | - |
| Premiums paid on derivative instruments (see Note 14) | 25,869 | 32,197 |
| Prepaid expenses and other receivables | 8,590 | 2,571 |
| Accrued pension benefit asset (see Note 13) | 7,974 | 9,912 |
| Fair value of derivative instruments ineligible for hedge accounting (see Note 14) | 6,551 | - |
| Other | 1,958 | 1,242 |
| | $ 247,214 | $ 168,736 |

## NOTE 10 DEPOSITS

The repayment of all deposits without limit, including accrued interest, is guaranteed by the Crown in right of Alberta in respect of which the Crown assesses an annual deposit guarantee fee against ATB. For the year ended March 31, 2005, the fee assessed was $15,784 (2004: $11,836; 2003: $15,985).

Deposit balances are comprised as follows:

| | | | | 2005 | 2004 |
|---|---|---|---|---|---|
| | Payable on demand | Payable after notice | Payable on a fixed date | Total | Total |
| Personal | $ 1,377,381 | $ 1,007,625 | $ 5,618,412 | $ 8,003,418 | $ 7,815,239 |
| Business | 2,219,271 | 351,133 | 2,119,907 | 4,690,311 | 4,421,069 |
| Financial institutions | - | - | 1,146,303 | 1,146,303 | 798,812 |
| | $ 3,596,652 | $ 1,358,758 | $ 8,884,622 | $13,840,032 | $13,035,120 |

Total deposits presented above include $171,321 (2004: 132,126) denominated in U.S. funds.

As at March 31, 2005, deposits by various departments and agencies of the government of the Province of Alberta included in the preceding schedule total $4,000 (2004: $6,596) and include deposits for loans made under the Alberta Farm Credit Stability Program in the amount of $2,579 (2004: $4,927).

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## NOTE 11 OTHER LIABILITIES

Other liabilities are comprised as follows:

| | 2005 | 2004 |
|---|---|---|
| Accrued interest payable | $ 137,058 | $ 143,863 |
| Accounts payable and accrued liabilities | 96,249 | 84,461 |
| Cheques & other items in transit | 69,000 | - |
| Deposit guarantee fee payable | 15,784 | 27,822 |
| Due to clients, brokers and dealers | 2,755 | 3,837 |
| Accrued pension benefit liability (see Note 13) | 2,504 | 2,330 |
| Other | 1,857 | - |
| | $ 325,207 | $ 262,313 |

## NOTE 12 SUBORDINATED DEBENTURES

ATB privately places debentures with the Crown in right of Alberta. These debentures, which are unsecured and subordinated to deposits and other liabilities, are issued in respect of ATB's obligation for the cost of the deposit guarantee to March 31, 2004. ATB's obligation for the deposit guarantee in respect of the year ended March 31, 2005 is recorded in "Other liabilities" in the Consolidated Balance Sheet (see Note 11).

These subordinated debentures are non-convertible, non-redeemable, non-transferrable, and bear a fixed rate of interest payable semi-annually.

Subordinated debentures are comprised as follows:

| Maturity Date | Interest Rate | 2005 | 2004 |
|---|---|---|---|
| June 30, 2004 | 5.475% | $ - | $ 7,519 |
| June 30, 2005 | 6.540% | 9,925 | 9,925 |
| June 30, 2006 | 5.840% | 12,738 | 12,738 |
| June 30, 2007 | 5.810% | 15,234 | 15,234 |
| June 30, 2008 | 4.287% | 15,985 | - |
| June 30, 2009 | 3.800% | 11,837 | - |
| | | $ 65,719 | $ 45,416 |

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## NOTE 13 EMPLOYEE FUTURE BENEFITS

ATB provides future benefits to current and past employees through a combination of defined benefit and defined contribution pension plans but does not provide any other employee future benefits.

ATB participates in the Public Service Pension Plan (or "PSPP") with other Alberta public sector employers. The PSPP is a defined benefit pension plan that provides pension benefits for ATB's non-management employees based on years of service and earnings. ATB accounts for the cost of its participation in PSPP on a defined contribution basis. Expenses related to this plan for the year ended March 31, 2005 were $4,136 (2004: $3,475; 2003: $2,845) and are recorded in "Salaries and employee benefits" in the Consolidated Statement of Income.

For its management employees, ATB provides a registered pension plan with defined benefit and defined contribution provisions and a defined benefit supplemental plan. Assets are set aside to satisfy the pension obligation of the registered plan. ATB has the ultimate responsibility for ensuring that the liabilities of the registered plan are adequately funded over time. The supplemental plan is not pre-funded and benefits are paid from ATB's assets as they become due.

The cost of the defined contribution provisions of the registered plan is recorded based on the contributions from ATB in the current year, and is included in "Salaries and employee benefits" in the Consolidated Statement of Income. For the year ended March 31, 2005, expenses related to this plan were $5,009 (2004: $3,668; 2003: $3,929).

The future employee benefits under the defined benefit and supplemental pension plans are based on years of service and highest average salary. Actuarial determination of the accrued benefit obligations uses the projected benefit method prorated on service, which incorporates management's best estimate of long-term investment returns, salary growth and other cost escalation factors, retirement ages of employees, mortality and other actuarial factors.

The significant accounting policies for the components of the change year to year in the accrued pension benefit obligation for the defined benefit provisions of the registered plan and the defined benefit supplemental plan and the related components of net pension benefit expense are as follows:

- Current service cost represents the cost of benefits earned by the subject employees in the current year. They are actuarially determined as the present value of the future benefits the employees will be entitled to upon retirement and are based upon the current provisions of ATB's benefit plans.

- Interest cost on benefit liabilities represents the increase in ATB's benefit obligations due to the passage of time.

- Expected return on plan assets represents management's best estimate of the long-term rate of return, net of investment expenses, that will be earned by the plan's assets based on a market-related value of those assets.

- The market-related value of plan assets is a calculated amount that recognizes changes in the fair value of assets in a systematic and rational manner over a period of four years, using a four-year moving average for all classes of assets, and is applied consistently from year to year.

ALBERTA TREASURY BRANCHES

**NOTE 13 (continued)**

- The long-term rate of return estimate is established based on the fund's target asset allocation and management's estimates of future inflation and the real rates of return each asset class will earn. The inflation estimate is derived by reference to the implied market spread between government long bond yields and real return bond yields. The real rate of return that debt securities are expected to earn is determined by reference to real return yields on bonds of duration similar to the plan's obligations. The real rate of return expected from equity securities is then determined by adding a reasonable estimate of equity risk premium.

- Actuarial experience gains or losses may arise in two ways. After each valuation our actuarial consultants recalculate the plans' benefit obligations and compare them to the estimated obligations extrapolated from the preceding valuation. Any difference between the expected accrued benefit obligation and the actual accrued benefit obligation is considered an actuarial gain or loss. In addition, any change in the accrued benefit obligation that arises from a change in assumptions is also classified as an actuarial gain or loss. Differences between actual and expected returns on plan assets will also give rise to an actuarial gain or loss.

- Each year, if the plan's net accumulated unrecognized actuarial gain or loss exceeds 10 per cent of the greater of (i) the accrued benefit obligations or (ii) the market-related value of plan assets, that excess amount is amortized over the average remaining service period of active employees for that plan. The first 10% of the net accumulated actuarial gain or loss continues to not be recognized for accounting purposes.

- An initial transition asset arose as of March 31, 1999 when ATB prospectively adopted the then-new accounting standard on employee future benefits. The transitional asset recognized is being amortized on a straight-line basis over 10 years, the expected average remaining service period of active employees expected to receive benefits as at that time.

- A past service amendment arose as of April 1, 2003 when the Supplemental Plan was amended to include limits to pensionable earnings. This amendment resulted in a reduction to the accrued benefit obligation related to then past-services. The effect of the past service amendment is being amortized on a straight-line basis over 14 years, the expected average remaining service period of active employees expected to receive supplemental benefits as at that time.

**Plan valuation, funding and asset allocation**

ATB measures its accrued benefit obligations and the market-related values of plan assets for accounting purposes as at March 31 each year. The most recent actuarial valuation of the registered pension plan and the supplemental plan for funding purposes was as of December 31, 2003, and the next required valuation date for funding purposes is December 31, 2006.

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**NOTE 13 (continued)**

ATB makes regular funding contributions to the registered defined benefit plan in accordance with the most recent valuation for funding purposes. The plan's investment policy sets targets for an acceptable range for the allocation of plan assets between equity, debt and other assets. The policy targets in effect as at March 31, 2005 were unchanged from 2004 and 2003. The plan's actual and target asset allocations are set out below.

| (in percent) | Normal | Target 2005 Max-Min | Actual 2005 | Actual 2004 | Actual 2003 |
|---|---|---|---|---|---|
| **Equities** | | | | | |
| Canadian | 40 | 30 - 50 | 43 | 43 | 45 |
| Foreign | 30 | 20 - 40 | 26 | 26 | 20 |
| | 70 | 60 - 75 | 69 | 69 | 65 |
| **Fixed income** | | | | | |
| Canadian | 30 | 25 - 40 | 31 | 31 | 35 |
| **Cash** | 0 | 00 - 15 | 0 | 0 | 0 |
| | 100 | | 100 | 100 | 100 |

**Net accrued pension benefit asset (liability)**

The funded status and net accrued pension benefit asset (liability) for the defined benefit provisions of the registered pension plan and the supplemental plan are comprised as follows:

| | 2005 | 2004 |
|---|---|---|
| **Registered plan** | | |
| Fair value of plan assets | $ 78,170 | $ 71,463 |
| Projected benefit obligation | (95,894) | (85,424) |
| Plan funding suplus (deficit) | (17,724) | (13,961) |
| Unamortized initial transition asset | (1,576) | (1,970) |
| Unamortized actuarial net loss (gain) | 27,274 | 25,843 |
| **Accrued pension benefit asset** | $ 7,974 | $ 9,912 |
| | | |
| **Supplemental plan** | | |
| Fair value of plan assets | $ - | $ - |
| Projected benefit obligation | (1,541) | (1,117) |
| Plan funding surplus (deficit) | (1,541) | (1,117) |
| Unamortized actuarial net loss (gain) | 74 | (90) |
| Unamortized past service amendment (gain) | (1,037) | (1,123) |
| **Accrued pension benefit liability** | $ (2,504) | $ (2,330) |

The net accrued pension benefit asset (liability) is included in "Other assets" or "Other liabilities" in the Consolidated Balance Sheet as appropriate. See Notes 9 or 11, respectively.

ALBERTA TREASURY BRANCHES

**NOTE 13 (continued)**

**Change in plan assets and benefit obligations**

Changes in the estimated financial position of the defined benefit provisions of the registered pension plan and the supplemental plan are comprised as follows:

| | Registered plan | | | Supplemental plan | | |
|---|---|---|---|---|---|---|
| | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** |
| **Change in fair value of plan assets** | | | | | | |
| Fair value of plan assets at beginning of year | $71,463 | $50,324 | $56,435 | $ - | $ - | $ - |
| Contributions from ATB | 1,611 | 10,974 | 1,252 | 19 | 19 | 54 |
| Contributions from employees | 1,042 | 987 | 935 | - | - | - |
| Actual return on plan assets | 5,896 | 10,602 | (6,861) | - | - | - |
| Benefits paid | (1,842) | (1,424) | (1,437) | (19) | (19) | (54) |
| **Fair value of plan assets at end of year** | $78,170 | $71,463 | $50,324 | $ - | $ - | $ - |
| **Change in projected benefit obligation** | | | | | | |
| Projected benefit obligation at beginning of year | $85,424 | $68,441 | $63,740 | $1,117 | $1,851 | $1,850 |
| Past service amendment | - | - | - | - | (1,210) | - |
| Actuarial loss (gain) | 3,975 | 11,048 | (691) | 164 | 282 | (766) |
| Current service cost | 2,119 | 2,530 | 2,491 | 207 | 163 | 675 |
| Employees' contributions | 1,042 | - | - | - | - | - |
| Interest cost | 5,176 | 4,829 | 4,338 | 72 | 50 | 146 |
| Benefits paid | (1,842) | (1,424) | (1,437) | (19) | (19) | (54) |
| **Projected benefit obligation at end of year** | $95,894 | $85,424 | $68,441 | $1,541 | $1,117 | $1,851 |

**Cash payments**

Total cash paid or payable for employee future benefits for the year ended March 31, 2005, consisting of cash contributed by ATB to its funded registered pension plan, cash payments directly to beneficiaries for its unfunded supplementary pension plan, and cash contributed to its defined contribution plan and the PSPP plan, was $10,775 (2004: $18,136; 2003: $8,080).

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**NOTE 13 (continued)**

**Defined benefit pension expense**

Pension benefit expense for the defined benefit provisions of the registered plan and for the supplemental plan is comprised as follows:

| | Registered plan | | | Supplemental plan | | |
|---|---|---|---|---|---|---|
| | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** |
| Current service cost | $ 2,119 | $ 1,543 | $ 1,556 | $ 207 | $ 163 | $ 675 |
| Interest cost on projected benefit obligation | 5,176 | 4,829 | 4,338 | 72 | 50 | 146 |
| Plan amendments | - | - | - | - | (1,210) | - |
| Actual return on plan assets | (5,896) | (10,602) | 6,861 | - | - | - |
| Actuarial experience (gains) losses | 3,975 | 11,048 | (691) | 164 | 282 | (766) |
| | 5,374 | 6,818 | 12,064 | 443 | (715) | 55 |
| **Adjustments to recognize the long-term nature of employee future benefit costs:** | | | | | | |
| Difference between actual and expected return on plan assets | 606 | 6,438 | (11,164) | - | - | - |
| Difference between actual actuarial experience (gains) losses arising and actuarial (gains) losses amortized | (2,037) | (9,878) | 1,316 | (164) | (306) | 780 |
| Difference between actual and recognized plan amendments | - | - | - | - | 1,124 | - |
| Amortization of initial transition asset | (394) | (394) | (394) | - | - | - |
| Amortization of past service amendment | - | - | - | (86) | - | - |
| **Net pension benefit expense recognized** | $ 3,549 | $ 2,984 | $ 1,822 | $ 193 | $ 103 | $ 835 |

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**NOTE 13 (continued)**

**Key assumptions and sensitivities**

The significant assumptions used in the actuarial determination of projected benefit obligations and the related net pension benefit expenses are, on a weighted average basis, as follows:

| | Registered plan | | | Supplemental plan | | |
|---|---|---|---|---|---|---|
| | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** |
| **Accrued benefit obligation as at March 31** | | | | | | |
| Discount rate at end of year | 5.90% | 6.00% | 7.00% | 5.90% | 6.00% | 7.00% |
| Rate of compensation increase | 4.45% | 4.25% | 4.75% | 4.50% | 4.50% | 5.00% |
| **Defined benefit expense for the year ended** | | | | | | |
| Discount rate at beginning of year | 6.00% | 7.00% | 6.75% | 6.00% | 7.00% | 6.75% |
| Expected long-term return on plan assets | 7.35% | 7.35% | 7.50% | - | - | - |
| Rate of compensation increase | 4.25% | 4.25% | 4.75% | 4.50% | 4.50% | 5.00% |
| Avg. remaining service period of active employees | 9 years | 9 years | 9 years | 14 years | 14 years | 14 years |

The following table outlines the possible impact of changes in certain key weighted average economic assumptions used to measure the accrued pension benefit obligations as at March 31, 2005 and the related expense for the year then ended.

This sensitivity analysis should be used with caution as it is hypothetical and the effect of changes in each significant assumption may not be linear. Also, the sensitivities in each key variable have been calculated independently of changes in other key variables and actual experience may result in changes to a number of key assumptions at the same time. Changes in one factor could result in changes to another that may serve to amplify or reduce certain sensitivities.

| | Registered plan | | Supplemental plan | |
|---|---|---|---|---|
| | **Benefit Obligation** | **Benefit Expense** | **Benefit Obligation** | **Benefit Expense** |
| **Discount rate (%)** | | | | |
| Impact of: 1.0% increase | $ (14,174) | $ (1,654) | $ (220) | $ (46) |
| 1.0% decrease | 18,099 | 2,275 | 275 | 43 |
| **Inflation rate (%)** | | | | |
| Impact of: 1.0% increase | 11,674 | 1,999 | (153) | (46) |
| 1.0% decrease | (9,938) | (1,497) | 233 | 52 |
| **Rate of compensation increase (%)** | | | | |
| Impact of: 0.25% increase | 827 | 248 | - | - |
| 0.25% decrease | (817) | (41) | - | - |
| **Expected long-term rate of return on plan assets (%)** | | | | |
| Impact of: 1.0% increase | - | (720) | - | - |
| 1.0% decrease | - | 720 | - | - |

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## NOTE 14 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts whose value is derived from an underlying reference rate such as an interest rate, currency exchange rate, the price of an equity or debt security or a credit instrument, or an equity or commodity index. ATB uses these instruments for risk management purposes and does not act as an intermediary in this market except insofar as ATB enters into derivative contracts with its customers where the purpose of the transaction is for the customer to hedge its own exposure to risks relating to interest rates, commodity prices and exchange rates. ATB does not accept any net exposure to such derivative contracts as it enters into offsetting contracts with other counterparties.

The main derivative financial instruments used by ATB include swaps, options and foreign exchange forward contracts.

**Swaps**

- Swaps are contractual arrangements whereby two parties agree to exchange a series of cash flows having specific characteristics in terms of interest rates (i.e. fixed or floating), currency exchange rates, commodity price, index values, etc. based on a notional principal amount for a specified period of time.
- The main risks associated with swaps are related to the exposure to movements in the underlying rate, price, value, etc. and the potential inability of the counterparty to meet its commitments under the terms of the contract.
- ATB uses interest rate swaps whereby it exchanges fixed and floating rate interest rate payments with a counterparty based on an agreed notional principal amount denominated in a single currency. These are used to manage exposure to interest rate fluctuations, primarily arising from the loan and deposit portfolios. Any resultant cash flows are recognized on an accrual basis in "Other assets" or "Other liabilities" in the Consolidated Balance Sheet, as appropriate.

**Options**

- Options are contractual arrangements where the party that writes an option contract conveys to the buyer the right, but not the obligation, to either buy or sell a specified amount of currency, commodities or financial instruments at a specified price on a future date or within a specified period of time. The writer charges a premium to the buyer as compensation for accepting the related market risk.
- The main risk to the buyer associated with non-exchange traded options is the potential credit risk if the writer of the contract fails to fulfill the conditions of the contract if the buyer exercises its right.
- ATB buys specialized forms of option contracts such as interest rate caps, collars and swap options as well as equity-linked and commodity-linked options direct from counterparties in the "over-the-counter" market. These are used to manage exposure to interest rate, equity and commodity fluctuations, primarily arising from the loan and deposit portfolios. Premiums paid are recognized in "Other assets" in the Consolidated Balance Sheet and are amortized over the term of the contract on a straight-line basis with the resultant expense recorded in "Interest expense" in the Consolidated Statement of Income.
- ATB does not write options except for those inherent to the structure of interest rate collars.

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**NOTE 14 (continued)**

**Foreign exchange forward contracts**

- Forwards are contractual agreements transacted in the "over-the-counter" markets (i.e. not purchased on market exchanges) to either buy or sell a specified amount of a currency, commodity or security at a specific price and date in the future.
- The main risks associated with forwards relate to the potential inability of the counter-party to meet the terms of the contract and from movements in the underlying currency, commodity or security process, as applicable.
- ATB uses foreign exchange forward contracts to manage currency exposure, either arising from its own foreign-currency denominated loans and deposits or for its customers.

**Derivatives held for asset/liability management**

ATB enters into a variety of derivative instruments for asset/liability management purposes, that is, to manage our interest rate, foreign exchange and commodity and equity-related exposures. These instruments, from April 1, 2004 onwards, are recorded using hedge accounting, when appropriate.

In order for a specific derivative instrument to qualify for hedge accounting under AcG-13, ATB must designate and formally document the hedge relationship at the inception of the agreement. The hedge relationship must also meet certain effectiveness criteria - changes in the fair value of the derivative instrument must be highly effective in offsetting either changes in the amount of future cash flows or changes in the fair values of the on-balance sheet items being hedged. Hedge effectiveness is evaluated both at the inception of the relationship and on a quarterly basis thereafter, primarily using quantitative measures of correlation with the item(s) the derivative is intended to hedge.

Hedging relationships that meet the conditions of AcG-13 qualify for hedge accounting whereby income and expenses on hedging instruments designated within qualifying hedges are recognized in the Consolidated Statement of Income in the same category and period as the related hedged items.

Any realized gains and losses from the early termination of a derivative financial instrument that qualified for hedge accounting are amortized over the remaining original life of the contract with the corresponding deferred gains or losses recorded in "Other assets" or "Other liabilities" in the Consolidated Balance Sheet, as appropriate.

**Derivatives ineligible for hedge accounting**

Derivatives used for asset/liability management purposes since April 1, 2004 that, either at inception or subsequently, do not meet the criteria for hedge accounting are accounted for as if they are "trading" derivatives. ATB does not enter into derivative contracts for trading purposes except to accommodate the foreign currency needs of its clients in managing their risk exposures. In such instances, the resultant exposure to ATB of any such derivative contract is simultaneously offset with another derivative contracts.

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**NOTE 14 (continued)**

Derivatives that do not meet the criteria for hedge accounting, either at inception or subsequently, are measured at fair value (or "marked to market") and are recorded as derivative financial instrument assets or liabilities on the Consolidated Balance Sheet with any subsequent unrealized changes in value recorded in "Other income" on the Consolidated Statement of Income.

**When an effective hedging relationship becomes ineffective**

A hedging relationship is terminated if it or an identifiable portion of it ceases to be highly effective, if the underlying asset or liability is terminated and the derivative is still outstanding, or if the derivative is no longer designated as a hedging instrument. When this occurs, the derivative instrument (or ineffective portion thereof) is marked to market and the resultant realized or unrealized gain or loss is deferred in "Other liabilities" or "Other assets" in the Consolidated Balance Sheet, as appropriate and then amortized into "Other income" over the remaining term of the instrument.

**Change in accounting policy**

As of April 1, 2004, ATB prospectively adopted the CICA Accounting Guideline 13 "Hedging Relationships" (AcG-13) and the Emerging Issues Committee abstract 128 "Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments" (EIC-128). AcG-13 provides detailed guidance and more stringent conditions for the use of hedge accounting, including the identification, designation, documentation and effectiveness of hedging relationships.

AcG-13 requires that the relationship between any hedging instrument and the hedged item(s) be specifically identified and documented. Prior to April 1, 2004, ATB hedged a significant portion of its interest rate risk on a net basis, a practice commonly referred to as "macro" or "economic" hedging. As AcG-13 does not allow for hedge accounting for these types of hedges, these hedges were replaced with AcG-13 compliant hedges that are identified with specific hedged items.

ATB reviewed and assessed each of its hedging relationships as of April 1, 2004. Hedge accounting was discontinued as of that date for those hedging relationships that failed to meet the AcG-13 criteria. AcG-13 requires that on transition, the difference between the carrying value and the fair value of these discontinued hedges be deferred and amortized over the remaining life of the hedging relationship. The impact of this transition was the recognition of an unrealized gain of $2,114 and an unrealized liability of $541 as of April 1, 2004. These amounts have been deferred in "Other assets" and "Other liabilities" in the Consolidated Balance Sheet, as appropriate, and will be amortized into "Interest expense" and "Interest income", respectively, over the original hedge terms, which range from one to five years. The net amount taken into income for the year ended March 31, 2005 was $1,132.

**Fair value of derivatives**

Fair value represents an estimate as at that point in time that may change in subsequent reporting periods due to changing market conditions or other factors. Fair value estimates of derivative financial instruments are determined using pricing models that take into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions.

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**NOTE 14 (continued)**

Fair value for over-the-counter interest rate derivatives is determined using generally accepted valuation techniques. When fair valuing over-the-counter fixed income derivative, zero coupon curves are created using underlying instruments such as cash, bonds, futures (exchange traded forward agreements) and off-balance sheet prices observable in the market. Option implied volatilities, a significant input to certain valuation models, are either obtained direct from market sources or calculated from market prices.

Fair value for over-the-counter equity and commodity derivatives is determined in a similar manner using generally accepted valuation techniques including consideration of option implied volatilities, correlations to market prices of the underlying and off-balance sheet prices observable in the market.

Fair value of derivative financial instruments, segregated between contracts in a favourable position (i.e. having positive fair value) and contracts in an unfavourable position (i.e. having negative fair value) is comprised as follows:

| | | | 2005 | | | 2004 |
|---|---|---|---|---|---|---|
| | Favourable position | Unfavourable position | Net | Favourable position | Unfavourable position | Net |
| **Contracts ineligible for hedge accounting Interest rate contracts** | | | | | | |
| Options | $ 923 | $ (92) | $ 831 | $ - | $ - | $ - |
| Swaps | 1,471 | (63) | 1,408 | - | - | - |
| | 2,394 | (155) | 2,239 | - | - | - |
| **Foreign exchange contracts** | | | | | | |
| Forward foreign exchange contracts | 76 | (70) | 6 | - | - | - |
| **Equity & commodity contracts** | | | | | | |
| Options | 5,176 | - | 5,176 | - | - | - |
| **Total fair value** | $ 7,646 | $ (225) | $ 7,421 | $ - | $ - | $ - |
| **Contracts eligible for hedge accounting** | | | | | | |
| **Interest rate contracts** | | | | | | |
| Options | $ 743 | $ (75) | $ 668 | $ 2,301 | $ - | $ 2,301 |
| Swaps | 41 | (432) | (391) | 1,530 | (2,023) | (493) |
| | 784 | (507) | 277 | 3,831 | (2,023) | 1,808 |
| **Foreign exchange contracts** | | | | | | |
| Forwards | - | - | - | - | (677) | (677) |
| Forward foreign exchange contracts | - | - | - | 53 | (57) | (4) |
| **Equity & commodity contracts** | | | | | | |
| Options | 50,100 | - | 50,100 | 37,225 | - | 37,225 |
| **Total fair value** | $50,884 | $ (507) | $ 50,377 | $41,109 | $ (2,757) | $ 38,352 |
| Total book value - contracts eligible for hedge accounting | | | 1,346,551 | | | 1,826,523 |

ALBERTA TREASURY BRANCHES

**NOTE 14 (continued)**

**Financial statement presentation**

Derivative financial instruments recorded in the Consolidated Balance Sheet as at March 31 are comprised as follows:

| | Assets 2005 | Assets 2004 | Liabilities 2005 | Liabilities 2004 |
|---|---|---|---|---|
| Fair value of derivatives ineligible for hedge accounting | $ 6,551 | $ - | $ - | $ - |
| Book value of derivatives eligible for hedge accounting | 387,501 | 516,446 | 959,050 | 1,310,077 |
| | $ 394,052 | $ 516,446 | $ 959,050 | $ 1,310,077 |

**Notional principal amounts**

The notional amounts of derivative instruments represent the underlying principal amount to which the specified rate or price is applied in order to calculate the amount of cash flows to be exchanged. Notional amounts do not represent assets or liabilities and are not recorded in the Consolidated Balance Sheet.

| | 2005 Ineligible for Hedge Accounting | 2005 Eligible for Hedge Accounting | 2005 Total | 2004 Net |
|---|---|---|---|---|
| **Interest rate contracts** | | | | |
| Options | $ 159,690 | $ 587,501 | $ 747,191 | $ 761,174 |
| Swaps | 850,000 | 450,000 | 1,300,000 | 635,000 |
| | 1,009,690 | 1,037,501 | 2,047,191 | 1,396,174 |
| **Foreign exchange contracts** | | | | |
| Forwards | - | - | - | 2,377 |
| Forward foreign exchange contracts | 7,273 | - | 7,273 | 5,272 |
| **Equity & commodity contracts** | | | | |
| Options | 28,160 | 309,050 | 337,210 | 422,700 |
| | $ 1,045,123 | $ 1,346,551 | $ 2,391,674 | $ 1,826,523 |

**Derivative-related credit risk**

Derivative financial instruments traded in the "over-the-counter" market are subject to credit risk in that there is a risk of a financial loss occurring if a counterparty defaults on its contractual obligation. This credit risk is normally a small fraction of the notional amount of the derivative instrument. ATB's maximum credit risk in respect of such derivatives is the positive fair value, or replacement cost, of all over-the-counter derivatives.

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**NOTE 14 (continued)**

ATB endeavours to limit its credit risk by dealing only with counterparties believed to be creditworthy and manages the credit risk for derivatives using the same credit risk process applied to loans and other credit assets. The exposure to credit risk on derivatives is also reduced by entering into master netting agreements with counterparties. To the extent any unfavourable contracts with the counterparty are not settled, they reduce ATB's net exposure in respect of favourable contracts with the same counterparty.

Exchange-traded derivative contracts are not considered to represent potential credit risk as they are settled net with each exchange rather than direct with the counterparties. ATB did not hold any such contracts during the years ended March 31, 2005, 2004 and 2003.

Credit risk exposure on the derivative portfolio is comprised as follows:

| | | | 2005 | 2004 |
|---|---|---|---|---|
| | Ineligible for Hedge Accounting | Eligible for Hedge Accounting | Total | Net |
| **Interest rate contracts** | | | | |
| Options | $ 923 | $ 743 | $ 1,666 | $ 2,301 |
| Swaps | 1,471 | 41 | 1,512 | 1,530 |
| | 2,394 | 784 | 3,178 | 3,831 |
| **Foreign exchange contracts** | | | | |
| Forwards | - | - | - | - |
| Forward foreign exchange contracts | 76 | - | 76 | 53 |
| **Equity & commodity contracts** | | | | |
| Options | 5,176 | 50,100 | 55,276 | 37,225 |
| **Total derivative exposure - gross** | $ 7,646 | $ 50,884 | $ 58,530 | $ 41,109 |
| Less impact of master netting agreements | | | (991) | (296) |
| **Residual credit exposure on derivatives** | | | $ 57,539 | $ 40,813 |

**Term to maturity**

The instruments in the derivative portfolio have varying maturity dates. The remaining contractual term to maturity for the notional amounts of all derivative instruments is as follows:

| | | | | | 2005 | 2004 |
|---|---|---|---|---|---|---|
| | Within 3 months | 3 to 12 months | 1 to 5 years | Over 5 years | Total | Total |
| **Interest rate contracts** | | | | | | |
| Options | $ - | $ 305,000 | $ 442,191 | $ - | $ 747,191 | $ 761,174 |
| Swaps | 200,000 | 1,100,000 | - | - | 1,300,000 | 635,000 |
| **Foreign exchange contracts** | | | | | | |
| Forwards | - | - | - | - | - | 2,377 |
| Forward foreign exchange contracts | 4,306 | 2,967 | - | - | 7,273 | 5,272 |
| **Equity & commodity contracts** | | | | | | |
| Options | - | 86,200 | 251,010 | - | 337,210 | 422,700 |
| **Total** | $ 204,306 | $ 1,494,167 | $ 693,201 | $ - | $ 2,391,674 | $ 1,826,523 |

ALBERTA TREASURY BRANCHES

## NOTE 15 COMMITMENTS, GUARANTEES AND CONTINGENT LIABILITIES

**Credit instruments**

In the normal course of business, ATB enters into various off-balance sheet commitments to provide customers with sources of credit. These may include letters of credit, letters of guarantee and loan guarantees and commitments to extend credit.

All of these credit arrangements are subject to ATB's normal credit standards, and collateral may be obtained where appropriate. The contract amounts represent the maximum credit risk exposure to ATB should the contracts be fully drawn, and any collateral held proves to be of no value. As many of these arrangements will expire or terminate without being drawn upon, the contract amounts do not necessarily represent the future cash requirements.

**Letters of credit**

Stand-by letters of credit represent an irrevocable obligation to make payments to a third party in the event that the customer is unable to meet its financial or performance contractual obligations. In the event of a call on such commitments, ATB has recourse against the customers.

Documentary and commercial letters of credit require ATB to honour drafts presented by third parties upon completion of specific activities.

**Guarantees**

Guarantees also represent an irrevocable obligation to make payments to a third party in certain situations. Guarantees include contracts or indemnities that contingently require ATB to make payments (either in the form of some asset or in the form of services) to a counterparty based on (a) changes in an underlying related to an asset, liability or equity the counterparty hold, (b) the failure of a third party to perform under an obligating agreement, or (c) failure of a third party to pay its indebtedness when due. Again, in the event of a call on such commitments, ATB has recourse against the customers.

ATB has also issued a $5.0 million guarantee to Canadian Depository for Securities (or "CDS") in respect of one its subsidiaries to support the settlement of investment transactions with CDS.

**Commitments to extend credit**

Commitments to extend credit represent undertakings by ATB to make credit available in the form of loans or other financing for specific amounts and maturities, subject to certain conditions, and include recently authorized credit not yet drawn down, and credit facilities available on a revolving basis.

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**NOTE 15 (continued)**

The contractual amounts of all such credit instruments as at March 31 are:

| | 2005 | 2004 |
|---|---|---|
| Guarantees | $ 104,405 | $ 95,168 |
| Letters of credit | 28,303 | 12,618 |
| Commitments to extend credit | 4,342,729 | 3,565,364 |
| | $ 4,475,437 | $ 3,673,150 |

The amounts presented above in the current and comparative year for commitments to extend credit include un-drawn lines of credit.

**Indemnification agreements**

In the normal course of operations, ATB enters in various agreements that provide general indemnification to the counterparty. Examples of such agreements would include service agreements, leasing agreements, clearing arrangements and service contracts. These indemnifications may require ATB, in certain circumstances, to compensate the counterparty for costs incurred as a result of various contingencies. ATB also indemnifies directors and officers, to the extent permitted by law, against certain claims that may be made against them as a result of their services to the company. The terms of these indemnifications vary based on the contract, the nature of which prevents ATB from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. Historically, any such amounts have not been significant. No amount has been accrued in the Consolidated Balance Sheet as at March 31, 2005, 2004 or 2003 in respect of such indemnifications.

**Contractual Obligations**

ATB has various obligations under long-term non-cancellable contracts, which includes service contracts and operating leases for buildings and equipment. The future minimum payments in respect of such obligations for each of the next five fiscal years and thereafter are:

| | |
|---|---|
| 2006 | $ 48,013 |
| 2007 | 47,164 |
| 2008 | 44,230 |
| 2009 | 34,353 |
| 2010 | 19,801 |
| 2011 and thereafter | 33,134 |
| | $ 226,695 |

The total expense in respect of operating leases charged to the Consolidated Statement of Income for the year ended March 31, 2005 is $45,662 (2004: $43,748; 2003: $43,839).

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**NOTE 15 (continued)**

**Pledged Assets**

In the ordinary course of business, ATB pledges securities to the Bank of Canada in order to participate in clearing and payment systems and to have access to its facilities. ATB also pledges securities to the CDS in order to participate in a settlement agent credit ring. The total amount of securities so pledged at March 31, 2005 is provided in Note 5.

**Contingent liabilities**

Various actions and legal proceedings arising from the normal course of business are pending against ATB. Management does not consider the aggregate liability, if any, of these actions and proceedings to be material.

## NOTE 16 DISCLOSURE OF SALARIES AND BENEFITS

ATB is an Agent of the Crown in right of Alberta, and as such, is required to disclose the following information as per the Salary and Benefits Disclosure Directive, as amended July 6, 2004, made by the Treasury Board, pursuant to sections 5, 6 and 7 of the Financial Administration Act. This directive applies to all departments, regulated funds, provincial agencies and Crown-controlled organizations. The amounts disclosed in the following table are the amounts earned in the year.

| | 2005 | | | | | | 2004 |
|---|---|---|---|---|---|---|---|
| | Base salary | Variable pay Current (1) | Variable pay Deferred (2) | Other cash benefits | Other non-cash benefits | Total | Total |
| Chairman of Board | $ 48 | $ - | $ - | $ - | $ - | $ 48 | $ 44 |
| Board Members (3) | 406 | - | - | - | - | 406 | 358 |
| President and Chief Executive Officer | 367 | 250 | 281 | 67 | 81 | 1,046 | 779 |
| Chief Operating Officer | 242 | 126 | 146 | 107 | 29 | 650 | 548 |
| Executive Vice-President Marketing (4) | 137 | - | - | 14 | 21 | 172 | 336 |
| Executive Vice-President Credit | 181 | 59 | 69 | 14 | 30 | 353 | 346 |
| Executive Vice-President Treasurer (5) | 168 | 55 | 64 | 14 | 32 | 333 | 26 |
| Chief Financial Officer (6) | 171 | 55 | 56 | 14 | 32 | 328 | 308 |
| Vice President Human Resources | 160 | 52 | 60 | 13 | 20 | 305 | 277 |

Notes:
(1) Variable pay is accrued based on goal attainment for the fiscal year but is paid following the fiscal year-end.
(2) Deferred variable pay is reported as earned in the year though payment is deferred for up to 2.5 years and is dependent upon the employee's continued employment with ATB. The actual amount each employee will receive will appreciate or depreciate from the amount reported above based on a specified methodology to reflect ATB's actual financial performance over the next two fiscal years.

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**NOTE 16 (continued)**

(3) The Board consists of eleven members plus the Chairman who is disclosed separately.

(4) This position was abolished effective October 22, 2004 and amounts presented do not include severance.

(5) This position was established effective March 1, 2004.

(6) Two incumbents occupied this position during the fiscal 2003-04 year.

Base salary consists of all regular pensionable base pay earned.

Other cash benefits consist of fees for attendance at meetings, retainers, honoraria, lump sum payments, perquisite allowances and any other direct cash remuneration.

Other non-cash benefits consists of ATB's share of all employee benefits and contributions or payments made on behalf of employees including statutory contributions, pension, health care, dental coverage, vision coverage, medical benefits, group life insurance, accidental disability and dismemberment insurance, long-term disability plans, tuition and professional memberships.

## NOTE 17 RELATED PARTY TRANSACTIONS

In the ordinary course of business, ATB provides normal banking services to various departments and agencies of the government of the Province of Alberta on terms similar to those offered to non-related parties (also see Note 10).

ATB provides banking services to its directors on terms similar to those offered to non-related parties and to its officers and employees at preferential rates. The total outstanding balances of residential mortgages and loans to all of these parties as at March 31 are as follows:

| | 2005 | 2004 |
|---|---|---|
| Residential mortgage | $ 133,229 | $ 118,942 |
| Personal loans | $ 52,846 | $ 46,804 |
| Credit card | 8,448 | 7,256 |
| Business | 5,672 | 5,737 |
| | $ 200,195 | $ 178,739 |

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## NOTE 18 ESTIMATED FAIR VALUE OF BALANCE SHEET FINANCIAL INSTRUMENTS

The following table presents management's best estimates of the fair value of its on-balance sheet financial instruments (except for derivative instruments which are presented separately in Note 14). The fair values are determined as at the balance sheet date using the valuation methods and assumptions described below. These values may change in subsequent reporting periods due to market conditions or other factors.

**Estimated fair value**

Estimated fair value represents the amount at which ATB would exchange a financial instrument in an arm's length transaction with a willing party under no compulsion to act. For those instruments with an available market price, fair value is established by reference to the last traded price prior to the balance sheet date. Many of ATB's financial instruments lack such an available trading market and the associated fair values presented represent management's best estimates of the current value of the instruments, taking into account changes in market rates (principally interest rates) or credit risk that have occurred since their origination.

Premises and equipment and accrued pension benefit asset and liability are not considered financial instruments and have been excluded from the estimates of fair value. The net carrying value of such amounts excluded totalled $115,537 as at March 31, 2005 (2004: $100,598).

**Financial instruments whose book value approximates fair value**

For items that are short-term in nature, the estimated fair value is considered to be equal to their carrying value. These include cash resources and, except for amounts recognized in respect of derivative instruments, other assets and other liabilities.

**Securities**

The fair value of equity securities is determined by reference to quoted marked prices. The fair value of debt securities is considered approximately equal to their carrying value, as their remaining terms to maturity are short enough that their value is effectively immune to changes in the interest rate environment.

**Loans and deposits**

For floating rate financial instruments, fair value is equal to carrying value as the interest rates automatically re-price to market. For fixed rate loans, fair value is determined by discounting the expected future cash flows at market rates. For fixed rate deposits, fair value is determined by discounting the contractual cash flows using market interest rates currently offered for deposits with similar terms. Due to the use of subjective assumptions and uncertainties, the fair value amounts should not be interpreted as being realizable in an immediate settlement of the instruments.

**Subordinated debentures**

The fair value of subordinated debentures is determined by discounting the contractual cash flows using market reference rates currently offered for debt instruments with similar terms and risk ratings.

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**NOTE 18 (continued)**

**Estimated fair value**

The estimated fair value of balance sheet financial instruments as at March 31 is as follows:

| | 2005 Carrying value | 2005 Fair value | 2005 Fair value over carrying value | 2004 Carrying value | 2004 Fair value | 2004 Fair value over carrying value |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash resources | $ 953,523 | $ 953,523 | $ - | $1,058,008 | $1,058,008 | $ - |
| Securities | 932,511 | 932,511 | - | 854,997 | 854,997 | - |
| Loans | 13,137,917 | 13,462,963 | 325,046 | 12,131,053 | 12,472,755 | 341,702 |
| Other | 247,214 | 247,214 | - | 168,736 | 168,736 | - |
| Liabilities | | | | | | |
| Deposits | 13,840,032 | 13,925,228 | 85,196 | 13,035,120 | 13,135,449 | 100,329 |
| Other | 325,207 | 325,207 | - | 262,313 | 262,313 | - |
| Subord. Debent. | 65,719 | 67,346 | 1,627 | 45,416 | 48,232 | 2,816 |

## NOTE 19 INTEREST RATE RISK

ATB is subject to interest rate risk in that it earns interest income on interest-bearing assets, pays interest expense on interest-bearing liabilities and has certain off-balance sheet derivative instruments with values that are interest rate-sensitive. To the extent either that these assets, liabilities and financial instruments mature or re-price at different times or that the financial instruments do not effectively address any interest rate mismatch between the assets and liabilities, ATB is exposed to interest rate risk.

Interest rate risk is the risk that ATB's net income will decrease because of an adverse movement in interest rates. The following table details the gap between on- and off-balance sheet interest sensitive assets and interest sensitive liabilities, based on the earlier of the re-pricing or maturity date of both.

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**NOTE 19 (continued)**

The gap position presented in the following schedule is as of the close of the business on March 31, 2005. It represents the position of ATB as at that point in time only and may change significantly from day to day due to customer preferences and risk management policies.

| | Term to maturity/repricing | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within 3 months | 3 - 6 months | 6 - 12 months | Total within 1 year | 1 year to 5 years | Over 5 years | Non-interest sensitive | Total |
| **2005** | | | | | | | | |
| **Assets** | | | | | | | | |
| Cash | $ 26,279 | $ - | $ - | $ 26,279 | $ - | $ - | $ - | $ 26,279 |
| Effective interest rate | 2.59% | - | - | 2.59% | - | - | - | 2.59% |
| Securities and interest bearing deposits with financial institutions | 1,781,208 | 42,554 | 35,994 | 1,859,755 | - | - | - | 1,859,755 |
| Effective interest rate | 2.61% | 2.73% | 2.86% | 2.61% | - | - | - | 2.61% |
| Loans | 7,677,466 | 331,690 | 649,465 | 8,658,621 | 4,520,016 | 34,793 | (75,513) | 13,137,917 |
| Effective interest rate | 4.99% | 6.20% | 5.95% | 5.11% | 5.45% | 4.54% | - | 5.25% |
| Other | - | - | - | - | - | - | 357,281 | 357,281 |
| | 9,484,953 | 374,244 | 685,459 | 10,544,655 | 4,520,016 | 34,793 | 281,768 | 15,381,232 |
| **Liabilities and Equity** | | | | | | | | |
| Deposits | 8,415,967 | 460,201 | 1,339,151 | 10,215,319 | 3,624,713 | - | - | 13,840,032 |
| Effective interest rate | 1.06% | 2.48% | 3.80% | 1.48% | 3.67% | - | - | 2.05% |
| Other liabilities and equity | - | - | - | - | - | - | 1,475,481 | 1,475,481 |
| Subordinated debentures | - | - | - | - | - | - | 65,719 | 65,719 |
| Effective interest rate | - | - | - | - | - | - | 5.19% | 5.19% |
| | 8,415,967 | 460,201 | 1,339,151 | 10,215,319 | 3,624,713 | - | 1,541,200 | 15,381,232 |
| On-balance sheet gap | 1,068,986 | (85,957) | (653,692) | 329,336 | 895,303 | 34,793 | (1,259,432) | 14,305,810 |
| **Derivatives used for asset/liability gap management** (notional amounts) | | | | | | | | |
| Pay side swaps | (1,300,000) | - | - | (1,300,000) | - | - | - | (1,300,000) |
| Effective interest rate | 3.54% | - | - | 3.54% | - | - | - | - |
| Receive side swaps | 200,000 | 400,000 | 700,000 | 1,300,000 | - | - | - | 1,300,000 |
| Effective interest rate | 2.39% | 2.81% | 2.96% | 2.83% | - | - | - | - |
| Off-balance sheet gap | (1,100,000) | 400,000 | 700,000 | - | - | - | - | - |
| Net gap | $ (31,014) | $ 314,043 | $ 46,308 | $ 329,336 | $ 895,303 | $ 34,793 | $(1,259,432) | $ - |
| As % of assets | (0.20%) | 2.04% | 0.30% | 2.14% | 5.82% | 0.23% | (8.19%) | - |
| **2004** | | | | | | | | |
| Assets | 8,647,932 | 435,040 | 742,398 | 9,825,370 | 4,247,721 | 48,394 | 184,325 | 14,305,810 |
| Liabilities | 7,509,107 | 1,039,500 | 1,233,329 | 9,781,936 | 3,253,059 | 125 | 1,270,690 | 14,305,810 |
| Off-balance sheet gap | (400,000) | 300,000 | 100,000 | - | - | - | - | - |
| Net gap | $ 738,825 | $(304,460) | $(390,931) | $ 43,434 | $ 994,662 | $ 48,269 | $(1,086,365) | $ - |
| As % of assets | 5.17% | (2.13%) | (2.73%) | 0.30% | 6.96% | 0.34% | (7.60%) | - |

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## NOTE 20 SEGMENTED INFORMATION

ATB has organized its operations and activities around the following three business segments or lines of business:

- Personal and Business Financial Services that comprises the branch and ABM network and provides financial services to individuals, independent business and agricultural customers;
- Corporate Financial Services which provides financial services to medium- and large-size borrowers; and
- Investor Services provides wealth management solutions including retail brokerage, mutual funds, portfolio management and investment advice to ATB customers.

ATB's operating activities are not considered to be geographically distributed for external reporting purposes, as all its operations are essentially limited to customers within the province of Alberta.

**Basis of presentation**

Results presented in the following schedule are based on ATB's internal financial reporting systems. The accounting policies used in these groupings are consistent with those followed in the preparation of the consolidated financial statements as disclosed in the other notes to the consolidated financial statements. As these lines of business are based on ATB's internal management structure, they may not be comparable to those of other financial institutions. Comparable information for the fiscal year ended March 31, 2003 is not available since ATB re-organized its operations into the three lines of business during that fiscal year.

ALBERTA TREASURY BRANCHES

**NOTE 20 (continued)**

| | Personal and Business | Corporate | Investor Services | Other Business Units * | Total |
|---|---|---|---|---|---|
| **2005** | | | | | |
| Net interest income | $ 323,441 | $ 40,395 | $ - | $ 34,910 | $ 398,746 |
| Other income | 105,973 | 10,913 | 10,337 | 12,085 | 139,308 |
| Total operating revenues | 429,414 | 51,308 | 10,337 | 46,995 | 538,054 |
| Provision for (recovery of) credit losses | 8,392 | (215) | - | (22,771) | (14,594) |
| Non-interest expenses | 300,954 | 13,703 | 22,301 | 28,377 | 365,335 |
| Net income (loss) | $ 120,068 | $ 37,820 | $ (11,964) | $ 41,389 | $ 187,313 |
| Total assets | $ 11,249,427 | $ 1,956,059 | $ 35,672 | $ 2,140,074 | $ 15,381,232 |
| **2004** | | | | | |
| Net interest income | $ 351,014 | $ 34,232 | $ - | $ 12,038 | $ 397,284 |
| Other income | 97,136 | 6,615 | 3,970 | 8,551 | 116,272 |
| Total operating revenues | 448,150 | 40,847 | 3,970 | 20,589 | 513,556 |
| Provision for (recovery of) credit losses | 20,139 | 5,504 | - | (9,784) | 15,859 |
| Non-interest expenses | 283,004 | 7,189 | 12,084 | 23,396 | 325,673 |
| Net income (loss) | $ 145,007 | $ 28,154 | $ (8,114) | $ 6,977 | $ 172,024 |
| Total assets | $ 10,759,963 | $ 1,441,411 | $ 27,859 | $ 2,076,577 | $ 14,305,810 |

* Comprised of business units of a corporate nature such as investment, risk management, asset liability management and treasury operations, as well as expenses and general allowances and recoveries for credit losses not expressly attributed to the three lines of business.

# ATB INVESTMENT MANAGEMENT INC.

## Financial Statements

YEAR ENDED MARCH 31, 2005

AUDITOR GENERAL
Alberta

# AUDITOR'S REPORT

**To the Board of Directors of ATB Investment Management Inc.**

I have audited the balance sheet of ATB Investment Management Inc. as at March 31, 2005 and the statements of operations, shareholder's deficiency and cash flows for the year then ended. These financial statements are the responsibility of ATB Investment Management Inc.'s management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of ATB Investment Management Inc. as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 25, 2005

ATB INVESTMENT MANAGEMENT INC.

## BALANCE SHEET

As at March 31, 2005

| | 2005 | (Restated - Note 3) 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash | $ 1,950,727 | $ 1,187,554 |
| Accounts receivable | 958,562 | 357,931 |
| Clients' cash held in trust | - | 797,653 |
| Prepaid expenses | 10,733 | 8,563 |
| | 2,920,022 | 2,351,701 |
| **Non-current assets** | | |
| Deferred charges | 29,058 | 46,472 |
| **Total assets** | $ 2,949,080 | $ 2,398,173 |
| **LIABILITIES AND SHAREHOLDER'S DEFICIENCY** | | |
| **Current liabilities** | | |
| Due to ATB (Note 4) | $ 941,851 | $ 280,914 |
| Accrued liabilities | 593,972 | 218,847 |
| Due to clients | - | 797,653 |
| | 1,535,823 | 1,297,414 |
| **Non-current liabilities** | | |
| Subordinated notes (Note 5) | 2,245,000 | 2,245,000 |
| | 3,780,823 | 3,542,414 |
| **Shareholder's deficiency** | | |
| Share capital (Note 6) | 5,000 | 5,000 |
| Deficiency | (836,743) | (1,149,241) |
| | (831,743) | (1,144,241) |
| **Total liabilities and shareholder's deficiency** | $ 2,949,080 | $ 2,398,173 |

Approved by the Board of Directors:

B. Normand,
Chairman of the Board
and Chief Executive Officer

M. Frederick,
Chief Financial Officer

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT MANAGEMENT INC.

## STATEMENT OF OPERATIONS
For the year ended March 31, 2005

| | 2005 | (Restated - Note 3) 2004 |
|---|---|---|
| **Revenue** | | |
| Investment management fees | $ 5,717,870 | $ 1,695,124 |
| Interest revenue (Note 7) | 29,623 | 12,688 |
| Other revenue | 121,279 | - |
| | 5,868,772 | 1,707,812 |
| **Administration and selling expenses (Note 7)** | | |
| Salaries and employee benefits | 709,712 | 371,061 |
| Professional fees | 1,641,914 | 538,873 |
| Trailing commission | 2,459,790 | 749,105 |
| Expense absorption (Note 2) | 182,625 | 583,655 |
| Other expenses | 465,573 | 93,522 |
| Interest expense | 96,660 | 62,493 |
| | 5,556,274 | 2,398,709 |
| **Income/(Loss) for the year** | $ 312,498 | $ (690,897) |

## STATEMENT OF SHAREHOLDER'S DEFICIENCY
For the year ended March 31, 2005

| | 2005 | (Restated - Note 3) 2004 |
|---|---|---|
| Share capital | $ 5,000 | $ 5,000 |
| Deficiency, beginning of year, as previously reported | (959,098) | (458,344) |
| Correction of error (Note 3) | (190,143) | - |
| Deficiency, beginning of year, as restated | (1,149,241) | (458,344) |
| Income/(Loss) for the year | 312,498 | (690,897) |
| Deficiency, end of year | (836,743) | (1,149,241) |
| **Total shareholder's deficiency** | $ (831,743) | $ (1,144,241) |

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT MANAGEMENT INC.

## STATEMENT OF CASH FLOWS

For the year ended March 31, 2005

| | 2005 | (Restated - Note 3) 2004 |
|---|---|---|
| **Cash flows from (used in) operating activities** | | |
| Income/(loss) for the year | $ 312,498 | $ (690,897) |
| Items not affecting cash | | |
| Amortization of deferred charges | 17,414 | 17,413 |
| | $ 329,912 | $ (673,484) |
| Changes in non-cash working capital | | |
| Increase in accounts receivable | (600,631) | (357,931) |
| Increase in prepaid expenses | (2,170) | (8,563) |
| Increase in accrued liabilities | 375,125 | 218,847 |
| | 102,236 | (821,131) |
| **Cash flows from financing activities** | | |
| Change in due to ATB | 660,937 | (41,315) |
| Issue of subordinated notes | - | 1,800,000 |
| | 660,937 | 1,758,685 |
| **Net increase in cash** | 763,173 | 937,554 |
| **Cash, beginning of year** | 1,187,554 | 250,000 |
| **Cash, end of year** | $ 1,950,727 | $ 1,187,554 |
| **Supplementary cash flow information** | | |
| Interest paid | $ 95,613 | $ 55,464 |
| Interest received | $ 29,623 | $ 12,688 |

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT MANAGEMENT INC.

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

## NOTE 1 INCORPORATION AND OPERATIONS

ATB Investment Management Inc. (ATBIM) is a wholly owned subsidiary of Alberta Treasury Branches (ATB) established for the purpose of managing a family of ATB mutual fund portfolios and other provisions of discretionary portfolio management services. The continuing operations of ATBIM are dependent upon ATB's ongoing financial support. ATBIM was incorporated in Alberta under the *Business Corporations Act* (Alberta) on August 21, 2002. As a provincial corporation, ATBIM is exempt from income tax. ATBIM is registered with the Alberta Securities Commission (ASC).

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared by management in accordance with Canadian generally accepted accounting principles. In preparing the financial statements, management makes estimates and assumptions considering values of certain assets, liabilities, revenues, expenses and related disclosures reported in the financial statements. Actual results could differ from these estimates. Certain comparative amounts have been reclassified where necessary to conform to the current year's presentation. The significant accounting policies followed in the preparation of these financial statements are summarized below:

**Revenue recognition**

Investment management fees are based on net asset values of the ATB mutual fund portfolios and are recognized on an accrual basis. Interest revenue includes interest earned on cash deposits with ATB and is recorded on an accrual basis. Other revenue includes fees earned from clients for management of their accounts.

**Cash**

Cash consists of cash on deposit with ATB

**Clients' cash held in trust**

Clients' cash held in trust represents amounts in trust accounts with Royal Bank of Canada for the settlement of mutual fund transactions. The corresponding liabilities are included in due to clients.

**Deferred charges**

Deferred charges represent the unamortized cost of the implementation fees for setting up the registrar and the transfer agent for the mutual fund portfolios. Amortization is calculated on a straight-line basis, over the four-year term of the related contract. The amortization expense is charged to the mutual fund portfolios over the same contract term, as set out in the management agreement.

ATB INVESTMENT MANAGEMENT INC.

**NOTE 2 (continued)**

**Expense absorption**

In its sole discretion, ATBIM may waive or absorb expenses of the ATB Compass Portfolio mutual funds. The effect of such waivers and absorption is to recognize expenses of $182,625 (2004 - $583,655) that are otherwise attributable to the funds. It is expected that such waivers and absorption will decline as the net assets of the funds grow over time.

## NOTE 3 CORRECTION OF PRIOR PERIOD

During the year, the Company paid $124,481 in fees and expenses to third parties that related to the prior year. In addition, $65,662 in bonuses were paid to executives during the year that related to the prior year. These expenses were not accrued for in fiscal 2004, accordingly these amounts, totalling $190,143 have been corrected by restating the prior year.

## NOTE 4 DUE TO ATB

In the normal course of operations, ATB pays expenses and collects revenues on behalf of ATBIM. These amounts are recorded as payable and receivable in the respective accounts of both ATB and ATBIM. The amounts due to and from ATB are generally repaid in the following month.

The amount due to ATB is subject to interest charges at ATB's prime lending rate. The prime lending rate at March 31, 2005 was 4.25% (2004 - 4.0%).

## NOTE 5 SUBORDINATED NOTES

The subordinated notes held by ATB are unsecured and bear interest at the prime lending rate of ATB. The subordinated notes have no specified maturity dates and are repayable upon demand by ATB, subject to the prior approval of the Alberta Securities Commission. Since ATB does not have the unilateral right to demand repayment, the subordinated notes have been classified as a non-current liability.

ATB INVESTMENT MANAGEMENT INC.

## NOTE 6 SHARE CAPITAL

Authorized:

- An unlimited number of Class A voting common shares without nominal or par value.
- An unlimited number of Class B non-voting common shares without nominal or par value.
- An unlimited number of 10% non-cumulative redeemable non-voting preferred shares without nominal or par value, redeemable at $100 per share.

Issued:

| | 2005 | 2004 |
|---|---|---|
| 100 Class A Voting Common Shares | $ 5,000 | $ 5,000 |

## NOTE 7 RELATED PARTY TRANSACTIONS

In the normal course of operations, ATB charges ATBIM for certain administrative and selling services as well as charging interest on subordinated notes and amounts owing to ATB. In addition, ATB Securities Inc. (an affiliate) charges ATBIM for client referral fees and for costs incurred related to transaction processing for ATBIM clients. ATB Securities Inc. and ATB Investment Services Inc. (an affiliate) charge trailing commission fees to ATBIM on the sale of mutual funds. Where determinable, ATB allocates costs for employees of ATB providing services to ATBIM. ATBIM recovers from ATB, ATB Investment Services Inc. (an affiliate) and ATBS certain salary costs. The summary of these transactions is as follows:

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **REVENUE** | | | | |
| ATB | Interest income | Other revenue | $ 29,623 | $ 12,688 |
| **ADMINISTRATION & SELLING EXPENSES** | | | | |
| ATB Investment Services Inc. | Trailer fees | Trailing commission | $ 1,135,445 | $ 482,432 |
| ATB Securities Inc. | Trailer fees | Trailing commission | 1,324,345 | 266,673 |
| ATB | Employee services | Professional fees | 116,242 | 36,675 |
| ATB | Information technology and rent | Other expenses | 130,715 | 12,800 |
| ATB Securities Inc. | Client referral fees | Professional fees | 102,229 | - |
| ATB Securities Inc. | Transaction fees | Other expenses | 42,510 | - |
| ATB Securities Inc. | Salaries | Salaries & employee benefits | 44,700 | 44,700 |
| | | | $ 2,896,186 | $ 843,280 |

ATB INVESTMENT MANAGEMENT INC.

**NOTE 7 (continued)**

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **SALARIES AND EMPLOYEE BENEFITS** | | | | |
| ATB | Salaries (recoveries) | Salaries and employee benefits | $ (58,919) | $ (56,113) |
| ATB Investment Services Inc. | Salaries (recoveries) | Salaries and employee benefits | (8,417) | (17,727) |
| ATB Securities Inc. | Salaries (recoveries) | Salaries and employee benefits | (8,417) | (17,727) |
| | | | $ (75,753) | $ (91,567) |
| **INTEREST EXPENSE** | | | | |
| ATB | Interest expense on subordinated notes | Interest expense | $ 90,034 | $ 56,082 |
| ATB | Interest expense on due to ATB | Interest expense | 6,626 | 5,617 |
| | | | $ 96,660 | $ 61,699 |

The above transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## NOTE 8 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The fair value of cash, accounts receivable and accrued liabilities approximates the carrying value due to the short-term nature of these instruments. The fair value of amounts due to ATB and subordinated notes is not readily determinable as there are no fixed terms of repayment.

## NOTE 9 INTEREST RATE RISK

ATBIM is subject to interest rate risk in that the amounts due to ATB and the subordinated notes are subject to fluctuations in interest rates. For each 1% change in the rate of interest on these obligations, the change in annual interest expense is approximately $27,000 (2004 - $22,000) based on the outstanding balances at March 31, 2005. This would be partially offset by increased interest earned on deposits.

# ATB INVESTMENT SERVICES INC.

## Financial Statements

YEAR ENDED MARCH 31, 2005

AUDITOR
GENERAL
*Alberta*

# AUDITOR'S REPORT

**To the Board of Directors of ATB Investment Services Inc.**

I have audited the balance sheet of ATB Investment Services Inc. as at March 31, 2005 and the statements of operations, shareholder's deficiency and cash flows for the year then ended. These financial statements are the responsibility of ATB Investment Services Inc.'s management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of ATB Investment Services Inc. as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 25, 2005

ATB INVESTMENT SERVICES INC.

## BALANCE SHEET

As at March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash | $ 6,981,568 | $ 4,304,228 |
| Clients' cash held in trust | 3,908,937 | 5,065,043 |
| Due from clients | 277,778 | 326,591 |
| Trailer fees receivable | 72,485 | 71,623 |
| Prepaid expenses | 89,683 | 84,063 |
| **Total assets** | $ 11,330,451 | $ 9,851,548 |
| **LIABILITIES AND SHAREHOLDER'S DEFICIENCY** | | |
| **Current liabilities** | | |
| Due to clients | $ 2,247,952 | $ 3,550,814 |
| Due to brokers and dealers | 1,878,251 | 1,840,820 |
| Due to ATB (Note 3) | 610,340 | 449,393 |
| Variable compensation payable | 702,562 | 91,367 |
| Accrued liabilities | 107,621 | 22,959 |
| Unearned revenue | 89,437 | - |
| | 5,636,163 | 5,955,353 |
| **Non-current liabilities** | | |
| Subordinated notes (Note 4) | 21,499,000 | 12,749,000 |
| | 27,135,163 | 18,704,353 |
| Commitments (Note 5) | | |
| **Shareholder’s deficiency** | | |
| Share capital (Note 6) | 1,000 | 1,000 |
| Deficiency | (15,805,712) | (8,853,805) |
| | (15,804,712) | (8,852,805) |
| **Total liabilities and shareholder's deficiency** | $ 11,330,451 | $ 9,851,548 |

Approved by the Board of Directors:

B. Normand,
Chairman of the Board
and Chief Executive Officer

M. Frederick,
Chief Financial Officer

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT SERVICES INC.

## STATEMENT OF OPERATIONS
For the year ended March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| **Revenue (Note 7)** | | |
| Commission revenue | $ 1,984,208 | $ 1,601,161 |
| Deposit instruments | 515,478 | 186,023 |
| Client fees | 103,483 | 71,327 |
| Interest | 101,910 | 63,126 |
| Other revenue | 9,418 | 8,048 |
| | 2,714,497 | 1,929,685 |
| **Administration and selling expenses (Note 7)** | | |
| Salaries and employee benefits | 3,393,232 | 2,506,562 |
| Processing, selling and premises rental | 2,713,000 | 2,125,094 |
| Other expenses | 1,268,739 | 697,879 |
| Variable compensation expense | 1,021,764 | 378,032 |
| Interest on subordinated debt | 642,146 | 376,206 |
| Professional and training | 606,880 | 536,569 |
| Other interest expense | 20,643 | 24,204 |
| **Total expenses** | 9,666,404 | 6,644,546 |
| **Loss for the year** | 6,951,907 | 4,714,861 |

## STATEMENT OF SHAREHOLDER'S DEFICIENCY
For the year ended March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| Share capital | $ 1,000 | $ 1,000 |
| Deficiency, beginning of year | 8,853,805 | 4,138,944 |
| Loss for the year | 6,951,907 | 4,714,861 |
| Deficiency, end of year | 15,805,712 | 8,853,805 |
| **Total shareholder's deficiency** | $ 15,804,712 | $ 8,852,805 |

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT SERVICES INC.

## STATEMENT OF CASH FLOWS

For the year ended March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| **Cash flows used in operating activities** | | |
| Loss for the year | $ (6,951,907) | $(4,714,861) |
| Changes in non-cash working capital | | |
| Increase in trailer fees receivable | (862) | (71,623) |
| Increase in prepaid expenses | (5,620) | (31,198) |
| Increase in bonuses payable | 611,195 | 91,367 |
| Increase in accrued liabilities | 84,662 | 22,959 |
| Increase in unearned revenue | 89,437 | - |
| Decrease in client cash | (60,512) | - |
| | (6,233,607) | (4,703,356) |
| **Cash flows from financing activities** | | |
| Increase in due to ATB | 160,947 | 357,584 |
| Issue of subordinated notes | 8,750,000 | 8,350,000 |
| | 8,910,947 | 8,707,584 |
| **Net increase in cash** | 2,677,340 | 4,004,228 |
| **Cash, beginning of year** | 4,304,228 | 300,000 |
| **Cash, end of year** | $ 6,981,568 | $ 4,304,228 |
| **Supplementary cash flow information** | | |
| Interest paid | $ 626,097 | $ 368,599 |
| Interest received | $ 101,910 | $ 63,126 |

*The accompanying notes are an integral part of these financial statements.*

ATB INVESTMENT SERVICES INC.

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

## NOTE 1 INCORPORATION AND OPERATIONS

ATB Investment Services Inc. (ATBIS) is a wholly owned subsidiary of Alberta Treasury Branches (ATB) established for the purpose of distributing mutual funds to customers of ATB. The continuing operations of ATBIS are dependent upon ATB's ongoing financial support. ATBIS was incorporated under the Business Corporations Act (Alberta) on October 3, 1997. As a provincial corporation, ATBIS is exempt from income tax. ATBIS is a member of the Mutual Fund Dealers Association of Canada (MFDA) and is registered with the Alberta Securities Commission (ASC).

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared by management in accordance with Canadian generally accepted accounting principles. In preparing the financial statements, management makes estimates and assumptions considering values of certain assets, liabilities, revenues, expenses and related disclosures reported in these financial statements. Actual results could differ from these estimates. Certain comparative amounts have been reclassified where necessary to conform to the current year's presentation. The significant accounting policies followed in the preparation of these financial statements are summarized below.

**Revenue recognition**

ATBIS receives its revenue from third party clients and affiliates (Note 7) for providing services as a distributor of mutual funds and other investment products. Commission revenue includes revenue earned on mutual fund sales that is recognized on a trade-date basis and trailer fee revenue that is recognized on an accrual basis as these fees are earned.

Deposit instruments revenue includes Guaranteed Investment Certificate (GIC) referral revenue, which is paid by ATB to ATBIS on a percentage of GIC sales. Client fees include Registered Retirement Savings Plan (RRSP) administration fees, as well as fees to transfer and deregister client accounts. Interest income includes interest earned from cash operating accounts. Other revenue includes miscellaneous ancillary fees earned from third parties. Deposits instruments revenue, client fees, interest income, and other revenue are all recognized on an accrual basis.

Unearned revenue relates to RRSP administration fees on client accounts that are amortized into income over the calendar year.

**Cash**

Cash consists of cash on deposit with ATB.

ATB INVESTMENT SERVICES INC.

**NOTE 2 (CONTINUED)**

**Clients' cash held in trust**

Clients' cash held in trust represents amounts in trust accounts with ATB for the settlement of mutual fund transactions. The corresponding liabilities are included in due to clients, brokers and dealers. Client balances are reported on a trade-date basis.

**Due to clients and due to brokers and dealers**

Due to clients represents cash balances in client accounts. These amounts are due on demand.

Due to brokers and dealers represents amounts related to trades which have initiated but not settled.

## NOTE 3 DUE TO ATB

In the normal course of operations, ATB pays expenses and collects revenues on behalf of ATBIS. These amounts are duly recorded as payable and receivables in the respective accounts of both ATB and ATBIS. The amounts due to and from ATB are generally repaid in the following month. The amounts due to and due from ATB as at March 31 are as follows:

| | 2005 | 2004 |
|---|---|---|
| Due to ATB | $ 1,084,116 | $ 621,888 |
| Due from ATB | (473,776) | (172,495) |
| Total | $ 610,340 | $ 449,393 |

The net amount due to ATB is subject to interest charges at ATB's prime lending rate. The prime lending rate at March 31, 2005 was 4.25% (2004 - 4.00%).

## NOTE 4 SUBORDINATED NOTES

The subordinated notes held by ATB are unsecured and bear interest at the prime lending rate of ATB. The subordinated notes have no specified maturity dates, and are repayable upon demand by ATB, subject to the prior approvals of the ASC and the MFDA. Since ATB does not have the unilateral right to demand repayment, the subordinated notes have been classified as a non-current liability. The amounts outstanding at March 31 are as follows:

| | 2005 | 2004 |
|---|---|---|
| Beginning balance | $12,749,000 | $ 4,399,000 |
| Issuances | 8,750,000 | 8,350,000 |
| Ending balances | $21,499,000 | $12,749,000 |

ATB INVESTMENT SERVICES INC.

## NOTE 5 COMMITMENTS

ATBIS is committed to payments under service agreements for data processing services through November 2007 in the amount of approximately $1,029,000. Annual payments are:

| | |
|---|---|
| 2006 | $370,000 |
| 2007 | 393,000 |
| 2008 | 266,000 |

## NOTE 6 SHARE CAPITAL

Authorized:

- An unlimited number of Class A voting common shares without nominal or par value.

- An unlimited number of Class B non-voting common shares without nominal or par value.

- An unlimited number of 10% non-cumulative redeemable non-voting preferred shares without nominal or par value, redeemable at $100 per share.

Issued:

| | 2005 | 2004 |
|---|---|---|
| 100 Class A Voting Common Shares | $ 1,000 | $ 1,000 |

## NOTE 7 RELATED PARTY TRANSACTIONS

In the normal course of operations, ATBIS earns income in the form of trailer fees and interest and other income from their parent company (ATB) and ATB Investment Management Inc. (ATBIM), another wholly owned subsidiary of ATB. ATB also charges ATBIS for administrative and selling services, as well as charging interest on subordinated notes and amounts owing to ATB. ATBIS recovers from ATB certain administrative, processing and selling costs.

ATB INVESTMENT SERVICES INC.

**NOTE 7 (CONTINUED)**

The summary of these transactions at March 31 is as follows:

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **REVENUES** | | | | |
| ATBIM | Trailer fees | Commission Revenue | $ 1,135,445 | $ 482,432 |
| ATB | Interest income | Interest | 101,910 | 63,126 |
| ATB | GIC referral fees | Deposit Instruments | 515,478 | 186,023 |
| | | | $ 1,752,833 | $ 731,581 |
| **ADMINISTRATION & SELLING EXPENSES** | | | | |
| ATB | Processing | Processing, selling and premises rental | $ 2,260,361 | $ 1,636,103 |
| ATB | Selling | Processing, selling and premises rental | 364,488 | 317,515 |
| ATB | Premises and equipment rental | Processing, selling and premises rental | 394,594 | 365,568 |
| ATB | Employee services | Professional and training | 228,186 | 234,444 |
| ATB | Information technology | Other expenses | 426,839 | 291,200 |
| ATBS | Salaries | Salaries and employee benefits | 14,900 | 14,900 |
| ATBIM | Salaries | Salaries and employee benefits | 8,417 | 17,725 |
| | | | $ 3,697,785 | $ 2,877,455 |
| ATB | Salaries (recoveries) | Salaries and employee benefits | $ (212,931) | $ (473,336) |
| ATB | Processing (recoveries) | Processing, selling and premises rental | (306,441) | (194,093) |
| ATB | Training (recoveries) | Professional and training | (21,869) | - |
| ATB | Compliance (recoveries) | Administration and selling expenses | (441,753) | (226,936) |
| | | | $ (982,994) | $ (894,365) |

ATB INVESTMENT SERVICES INC.

**NOTE 7 (CONTINUED)**

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **INTEREST EXPENSE** | | | | |
| ATB | Interest expense on subordinated notes | Interest expense | $ 642,146 | $ 376,206 |
| ATB | Interest expense on subordinated notes | Interest expense | 16,897 | 24,204 |
| | | | $ 659,043 | $ 400,410 |
| | | | $ 3,373,834 | $ 2,383,500 |

The above transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## NOTE 8 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The fair value of cash, due from clients, trailer fees receivable, due to brokers and dealers, variable compensation payable and accrued liabilities approximates the carrying value due to the short-term nature of these instruments. The fair value of amounts due to ATB and subordinated notes is not readily determinable as there are no fixed terms of repayment.

## NOTE 9 INTEREST RATE RISK

ATBIS is subject to interest rate risk in that the amounts due to ATB and the subordinated notes are subject to fluctuations in interest rates. For each 1% change in the rate of interest on these obligations, the change in annual interest expense is approximately $218,000 (2004 - $132,000) based on the outstanding balances at March 31, 2005. This would be partially offset by increased interest earned on deposits.

# ATB SECURITIES INC.

## Financial Statements

YEAR ENDED MARCH 31, 2005

# AUDITOR'S REPORT

**To the Board of Directors of ATB Securities Inc.**

I have audited the balance sheet of ATB Securities Inc. as at March 31, 2005 and the statements of operations, shareholder's deficiency and cash flows for the year then ended. These financial statements are the responsibility of ATB Securities Inc.'s management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of ATB Securities Inc. as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 13, 2005

ATB SECURITIES INC.

# BALANCE SHEET

As at March 31, 2005

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash | $ 13,744,332 | $ 9,680,836 |
| Clients' cash held in trust | 7,038,150 | 5,490,284 |
| Due from clients | 256,852 | 334,591 |
| Client fees receivable | 143,814 | 12,231 |
| Trailer fees receivable | 170,770 | 57,040 |
| Prepaid expenses | 38,270 | 34,572 |
| **Total assets** | $ 21,392,188 | $ 15,609,554 |
| **LIABILITIES AND SHAREHOLDER'S DEFICIENCY** | | |
| **Current liabilities** | | |
| Due to clients | $ 12,698,978 | $ 7,048,836 |
| Due to brokers and dealers | 876,735 | 3,836,915 |
| Due to ATB (Note 3) | 853,467 | 349,026 |
| Accrued liabilities | 808,179 | 171,594 |
| Unearned revenue | 21,429 | - |
| | 15,258,788 | 11,406,371 |
| **Non-current liabilities** | | |
| Subordinated notes (Note 4) | 13,995,000 | 6,995,000 |
| | 29,253,788 | 18,401,371 |
| Commitments (Note 5) | | |
| **Shareholder's deficiency** | | |
| Share capital (Note 6) | 5,000 | 5,000 |
| Deficiency | (7,866,600) | (2,796,817) |
| | (7,861,600) | (2,791,817) |
| **Total liabilities and shareholder's deficiency** | $ 21,392,188 | $ 15,609,554 |

*The accompanying notes are an integral part of these financial statements.*

Approved by the Board of Directors:

B. Normand
Chairman of the Board

M. Frederick
Chief Financial Officer

M. Mezei
Chief Executive Officer

ATB SECURITIES INC.

## STATEMENT OF OPERATIONS

| | for the year ended March 31, 2005 | for the 13 month period ended March 31, 2004 |
|---|---|---|
| **Revenue (Note 7)** | | |
| Mutual fund commissions | $ 2,504,049 | $ 658,223 |
| Securities commissions | 923,695 | 135,951 |
| Net interest | 393,089 | 227,596 |
| Client fees | 389,505 | 59,747 |
| Other revenue | 148,229 | - |
| | 4,358,567 | 1,081,517 |
| **Administration and selling expenses (Note 7)** | | |
| Salaries and employee benefits | 2,861,703 | 1,609,336 |
| Variable compensation expense | 2,831,152 | 690,392 |
| Processing fees | 1,135,003 | 403,204 |
| Professional fees | 595,893 | 456,964 |
| Interest on subordinated debt | 426,395 | 274,859 |
| Other interest expense | 17,023 | 10,010 |
| Other expenses | 1,561,181 | 433,569 |
| **Total expenses** | 9,428,350 | 3,878,334 |
| **Loss for the year** | $ (5,069,783) | $ (2,796,817) |

## STATEMENT OF SHAREHOLDER'S DEFICIENCY

| | for the year ended March 31, 2005 | for the 13 month period ended March 31, 2004 |
|---|---|---|
| Share capital | $ 5,000 | $ 5,000 |
| Deficiency, beginning of year | (2,796,817) | - |
| Loss for the year | (5,069,783) | (2,796,817) |
| Deficiency, end of year | (7,866,600) | (2,796,817) |
| **Total shareholder's deficiency** | $ 7,861,600 | $ (2,791,817) |

*The accompanying notes are an integral part of these financial statements.*

ATB SECURITIES INC.

## STATEMENT OF CASH FLOWS

| | for the year ended March 31, 2005 | for the 13 month period ended March 31, 2004 |
|---|---|---|
| **Cash flows from (used in) operating activities** | | |
| Loss for the year | $ (5,069,783) | $(2,796,817) |
| Changes in non-cash working capital | | |
| Increase in client fees receivable | (131,583) | (12,231) |
| Increase in trailer fees receivable | (113,730) | (57,040) |
| Increase in prepaid expenses | (3,698) | (34,572) |
| Increase in accrued liabilities | 636,585 | 171,594 |
| Increase in unearned revenue | 21,429 | - |
| Cash received from clients | 1,219,835 | 5,060,876 |
| | (3,440,945) | 2,331,810 |
| **Cash flows from financing activities** | | |
| Increase in due to ATB | 504,441 | 349,026 |
| Issue of subordinated notes | 7,000,000 | 6,000,000 |
| | 7,504,441 | 6,349,026 |
| **Increase in cash** | 4,063,496 | 8,680,836 |
| **Cash, beginning of year** | 9,680,836 | 1,000,000 |
| **Cash, end of year** | $ 13,744,332 | $ 9,680,836 |
| **Supplementary cash flow information** | | |
| Interest paid | $ 414,697 | $ 259,994 |
| Interest received | $ 393,089 | $ 227,596 |

*The accompanying notes are an integral part of these financial statements.*

ATB SECURITIES INC.

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

## NOTE 1 INCORPORATION AND OPERATIONS

ATB Securities Inc. (ATBS) is a wholly owned subsidiary of Alberta Treasury Branches (ATB) established to facilitate client trading of securities. The continuing operations of ATBS are dependent upon ATB's ongoing financial support. ATBS was incorporated in Alberta under the *Business Corporations Act* (Alberta) on February 6, 2003. ATBS commenced operations on July 26, 2003. As a provincial corporation, ATBS is exempt from income tax. ATBS is a member of the Investment Dealers Association of Canada (IDA) and the Canadian Investors Protection Fund (CIPF). The prior year comparatives include a thirteen month period of activity from the date of incorporation.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared by management in accordance with Canadian generally accepted accounting principles. Comparative amounts have been reclassified to conform to the current year's presentation. The significant accounting policies followed in the preparation of these financial statements are summarized below:

**Measurement uncertainty**

In preparing the financial statements, management makes estimates and assumptions considering values of certain assets, liabilities, revenues, expenses and related disclosures reported in these financial statements. Actual results could differ from these estimates.

**Revenue recognition**

ATBS earns its revenue from third party clients and affiliates (Note 7). Commission revenue earned on mutual fund sales and securities transactions is recognized on a trade-date basis. Trailer fee revenues are recognized on an accrual basis as they are earned.

Other revenue is recorded on an accrual basis and includes client fees, Registered Retirement Savings Plan (RRSP) administration fees, Guaranteed Investment Certificate (GIC) referral revenue, interest income, client referral fee income, and client transaction fee income. GIC referral fees are paid by ATB to ATBS based on the imputed profit earned on the GIC's. Client referral fees are paid by ATB Investment Management Inc. (ATBIM), an affiliate, to ATBS based on actual commissions paid to ATBS sales staff. Transaction fees are paid by ATBIM to ATBS based on fair market costs of client trade processing.

Unearned revenue relates to RRSP administration fees on client accounts that are amortized into income over the calendar year.

ATB SECURITIES INC.

**NOTE 2 (continued)**

**Cash**

Cash consists of cash on deposit with ATB.

**Client cash held in trust**

Included in clients' cash held in trust are amounts with respect to Registered Retirement Savings Plans and Registered Retirement Income Funds segregated in trust accounts with Canadian Western Trust. Corresponding liabilities are included in Due to clients. Client balances are reported on a trade date basis.

**Due to clients and Due to brokers and dealers**

Due to clients represents cash balances in client accounts. These amounts are due on demand.

Due to brokers and dealers represents amounts related to trades which have initiated but not been settled.

## NOTE 3 DUE TO ATB

In the normal course of operations, ATB pays expenses and collects revenues on behalf of ATBS. These amounts are duly recorded, as payable and receivables, in both ATB's and ATBS' accounts. The amounts due to and due from ATB are generally repaid in the following month.

| | 2005 | 2004 |
|---|---|---|
| Due to ATB | $ 1,074,135 | $ 516,014 |
| Due from ATB | (220,668) | (166,988) |
| Total | $ 853,467 | $ 349,026 |

The net amount due to ATB is subject to interest charges at ATB's prime lending rate. The prime lending rate at March 31, 2005 was 4.25% (2004 - 4.00%).

## NOTE 4 SUBORDINATED NOTES

The subordinated notes held by ATB are unsecured and bear interest at the prime lending rate of ATB. The subordinated notes have no specified maturity dates, and are repayable upon demand by ATB, subject to the prior approvals of the IDA. Since ATB does not have the unilateral right to demand repayment, the subordinated notes have been classified as a non-current liability.

| | 2005 | 2004 |
|---|---|---|
| February 11, 2003 | $ 995,000 | $ 995,000 |
| May 22, 2003 | 6,000,000 | 6,000,000 |
| July 29, 2004 | 5,000,000 | - |
| February 16, 2005 | 2,000,000 | - |
| Total | $13,995,000 | $6,995,000 |

ATB SECURITIES INC.

## NOTE 5 COMMITMENTS

ATBS is committed to payments under service agreements for data processing services through November 2007 in the amount of approximately $208,000. Annual payments are:

| | |
|---|---|
| 2006 | $ 78,000 |
| 2007 | 78,000 |
| 2008 | 52,000 |
| 2009 and thereafter | - |

## NOTE 6 SHARE CAPITAL

Authorized:

- An unlimited number of Class A voting common shares without nominal or par value.
- An unlimited number of Class B non-voting common shares without nominal or par value.
- An unlimited number of 10% non-cumulative redeemable non-voting preferred shares without nominal or par value, redeemable at $100 per share.

Issued and outstanding:

| | |
|---|---|
| 100 Class A Voting Common Shares | $ 5,000 |

## NOTE 7 RELATED PARTY TRANSACTIONS

In the normal course of operations, ATBS earns income in the form of trailer fees, and interest and other income from their parent company (ATB) and its other affiliates (ATBIM and ATB Investment Services Inc. (ATBIS)). ATB also charges ATBS for various administrative and selling services, as well as charging interest on subordinated notes and amounts owing to ATB. The summary of these transactions is as follows:

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **REVENUE** | | | | |
| ATBIM | Trailer fees | Commission revenue | $ 1,324,354 | $ 266,673 |
| ATBIM | Referral fees | Other revenue | 102,229 | - |
| ATBIM | Transaction fees | Other revenue | 42,510 | |
| ATB | Interest income/ | | | - |
| | GIC referral fees | Other revenue | 636,926 | 215,969 |
| | | | $ 2,106,019 | $ 482,642 |

ATB SECURITIES INC.

**NOTE 7 (continued)**

| RELATED PARTY | TRANSACTIONS | RECORDED AS | 2005 | 2004 |
|---|---|---|---|---|
| **ADMINISTRATION & SELLING EXPENSES** | | | | |
| ATB | Processing | Processing fees | $ 1,134,823 | $ 403,204 |
| ATB | Information technology & rent | Other expenses | 438,736 | 127,600 |
| ATB | Employee services | Professional fees | 127,194 | 83,127 |
| ATBIM | Salaries | Salaries & employee benefits | 8,417 | 17,725 |
| | | | $ 1,709,170 | $ 631,656 |
| ATBIM | Salaries (recoveries) | Salaries & employee benefits | $ (14,900) | $ (14,900) |
| ATBIM | Salaries (recoveries) | Salaries & employee benefits | (44,700) | (44,700) |
| | | | $ (59,600) | $ (59,600) |
| **INTEREST EXPENSE** | | | | |
| ATB | Interest expense on subordinated notes | Interest expense | $ 426,395 | $ 274,858 |
| ATB | Interest expense on due to ATB | Interest expense | 14,859 | 10,010 |
| | | | $ 441,254 | $ 284,868 |

The above transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

ATB SECURITIES INC.

## NOTE 8 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The fair value of cash, receivable from clients, trailer fees receivable, due to brokers and dealers and accrued liabilities approximates the carrying value due to the short-term nature of these instruments. The fair value of amounts due to ATB and subordinated notes is not readily determinable as there are no fixed terms of repayment.

## NOTE 9 INTEREST RATE RISK

ATBS is subject to interest rate risk in that amounts due to ATB and subordinated notes are subject to fluctuation in interest rates. For each 1% change in the rate of interest on these obligations, the change in annual interest expense is approximately $144,159 (2004 - $75,000) based on the outstanding balances at March 31, 2005. This would be partially offset by increased interest earned on deposits.

# CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Directors of the Credit Union Deposit Guarantee Corporation**

I have audited the balance sheet of the Credit Union Deposit Guarantee Corporation as at December 31, 2004 and the statements of income and equity and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
February 11, 2005

Fred J. Dunn, FCA
Auditor General

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## BALANCE SHEET

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash | $ 10,390 | $ 11,038 |
| Investments (Note 3) | 96,774 | 89,402 |
| Accrued interest receivable | 859 | 797 |
| Income taxes receivable | 228 | 79 |
| Due from credit unions | 2,735 | 2,630 |
| Other assets (Note 4) | 862 | 932 |
| Property and equipment (Note 5) | 124 | 169 |
| | $ 111,972 | $ 105,047 |
| **LIABILITIES** | | |
| Accounts payable and accrued liabilities | $ 797 | $ 661 |
| Accrual for financial assistance (Note 6) | 1,325 | 1,265 |
| Deferred revenue | 1,102 | 1,067 |
| Special contribution payable (Note 7) | 9,972 | 9,168 |
| Long-term unclaimed credit union balances payable | 483 | 476 |
| | 13,679 | 12,637 |
| Commitments and contingencies (Note 8) | | |
| **EQUITY** | | |
| Deposit Guarantee Fund | $ 96,601 | $ 90,253 |
| Master Bond Fund | 1,692 | 2,157 |
| | 98,293 | 92,410 |
| | $ 111,972 | $ 105,047 |

*The accompanying notes and schedule are part of these financial statements.*

Approved by the Board

R.A. Splane, Director

Mary C. Arnold, FCA, Director

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## STATEMENT OF INCOME AND EQUITY

For the year ended December 31, 2004 *(thousands)*

| | Budget (Note 11) | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **DEPOSIT GUARANTEE FUND** | | | |
| **Revenues:** | | | |
| Deposit guarantee assessments | $ 14,643 | $ 14,818 | $ 13,690 |
| Investment income | 4,770 | 5,530 | 6,044 |
| | 19,413 | 20,348 | 19,734 |
| **Expenses:** | | | |
| Provision for (recovery of) financial assistance (Note 6) | 225 | 58 | (445) |
| Special contribution (Note 7) | 9,726 | 9,972 | 9,168 |
| Administration expenses (Schedule 1) | 4,121 | 3,657 | 3,322 |
| | 14,072 | 13,687 | 12,045 |
| Income before income taxes | 5,341 | 6,661 | 7,689 |
| Income taxes (Note 9) | 109 | 313 | 541 |
| **Net income for the year** | 5,232 | 6,348 | 7,148 |
| **Equity at beginning of year** | 88,515 | 90,253 | 83,105 |
| **Equity at end of year** | $ 93,747 | $ 96,601 | $ 90,253 |
| **MASTER BOND FUND** | | | |
| **Revenues:** | | | |
| Insurance assessments | $ 1,159 | $ 1,123 | $ 983 |
| Investment income | 71 | 53 | 70 |
| | 1,230 | 1,176 | 1,053 |
| **Expenses:** | | | |
| Insurance premiums | 983 | 917 | 783 |
| Administration (Schedule 1) | 120 | 120 | 120 |
| Insurance claims | 112 | 604 | 87 |
| | 1,215 | 1,641 | 990 |
| **Net income (loss) for the year** | 15 | (465) | 63 |
| **Equity at beginning of year** | 2,210 | 2,157 | 2,094 |
| **Equity at end of year** | $ 2,225 | $ 1,692 | $ 2,157 |

*The accompanying notes and schedule are part of these financial statements.*

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## STATEMENT OF CASH FLOWS

For the year ended December 31, 2004 *(thousands)*

| | Budget (Note 11) | 2004 Actual | 2003 Actual |
|---|---|---|---|
| **Operating activities:** | | | |
| Assessments received | $ 15,686 | $ 15,916 | $ 14,469 |
| Interest income received | 4,622 | 5,521 | 6,180 |
| Financial assistance recovered (paid) | (225) | 2 | 10 |
| Interest and bank charges paid | (7) | (3) | (5) |
| Insurance claims paid | (112) | (389) | (231) |
| Income taxes paid | (109) | (459) | (637) |
| Paid to suppliers and employees | (5,143) | (4,620) | (4,198) |
| Special contribution paid | (9,005) | (9,168) | (8,354) |
| Cash flows from operating activities | 5,707 | 6,800 | 7,234 |
| **Investing activities:** | | | |
| Purchase of investments, net | (5,579) | (7,373) | (7,552) |
| Purchase of property and equipment | (128) | (75) | (58) |
| Cash flows used in investing activities | (5,707) | (7,448) | (7,610) |
| **Cash inflow (outflow)** | - | (648) | (376) |
| **Cash at beginning of year** | 10,000 | 11,038 | 11,414 |
| **Cash at end of year** | $ 10,000 | $ 10,390 | $ 11,038 |

*The accompanying notes and schedule are part of these financial statements.*

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 AUTHORITY AND PURPOSE

The Credit Union Deposit Guarantee Corporation (the "Corporation") operates under the authority of the Credit Union Act, Chapter C-32, revised Statutes of Alberta, 2000. The Corporation guarantees the repayment of all deposits with Alberta credit unions including accrued interest. The Credit Union Act provides that the Province of Alberta (Province) will ensure that this obligation of the Corporation is carried out. As at December 31, 2004, credit unions in Alberta held deposits including accrued interest totalling $8,963,176,000 (2003 - $8,240,499,000). Supervised credit unions receive assistance, support and direction in planning, policy and operational matters from the Corporation.

## NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of presentation**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

These financial statements reflect separate funds: a Deposit Guarantee Fund and a Master Bond Fund.

The primary objective of the Deposit Guarantee Fund is to enable the Corporation to guarantee the repayment of all deposits, including accrued interest, held by Alberta credit unions. The Deposit Guarantee Fund's statement of income includes deposit guarantee assessments received from credit unions, financial assistance payments recorded on behalf of credit unions, as well as all other revenues and expenses related to the primary objective.

The Master Bond Fund provides insurance coverage to Alberta credit unions under a policy administered by the Corporation. A credit union may claim a maximum of $100,000 for directors liability claims and $85,000 for other claims, less its deductible, which is payable out of the Master Bond Fund and a third party reinsurance policy insures the amount of the claim that exceeds $100,000 or $85,000 respectively. The Master Bond Fund's statement of income includes insurance assessments received from credit unions, investment income, insurance premiums paid for the reinsurance policy, an administration fee, and insurance claims paid.

**(b) Use of estimates**

The Corporation's financial statements are prepared in accordance with Canadian generally accepted accounting principles and necessarily include estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The most significant areas requiring the use of estimates are the accrual for financial assistance, provision for (recovery of) financial assistance, allowance for loan impairment and Master Bond Fund insurance claims (expected and unreported). The Corporation reviews these estimates annually. Actual amounts may differ significantly from those estimates depending upon certain future events and uncertainties.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

**NOTE 2 (continued)**

**(c) Cash**

Cash consists of a deposit in the Consolidated Cash Investment Trust Fund, which is managed by Alberta Finance to provide competitive interest income while maintaining maximum security and liquidity of depositor's capital.

**(d) Investments**

Investments are carried at cost or amortized cost, with any discount or premium amortized on a straight-line basis over the life of the investments. Investments are written down when there is a decline in value that is other than temporary. Gains and losses on sale of investments are included in with investment income in the year of sale. Substantially all securities held are purchased with the intention to hold them to maturity.

**(e) Property and equipment**

The following rates are designed to amortize the cost of property and equipment over their estimated useful lives:

| | |
|---|---|
| Furniture and equipment | five year straight-line |
| Computer equipment | three year straight-line |
| Leasehold improvements | straight-line over lease term |
| Computer software | one year straight-line |

The Corporation changed the amortization of computer equipment from 30 percent declining-balance to 3 year straight-line in order to more closely reflect its estimated useful life.

**(f) Income taxes**

The Corporation records income taxes based on the tax liability method. Therefore, future income taxes are recognized based on the tax effects that will arise if an asset is realized or a liability is settled for its carrying amount.

**(g) Insurance claims**

The Corporation estimates and accrues the Master Bond Fund's share of losses from any reported insurance claims. It makes an additional accrual of the estimated losses from unreported insurance claims based on the last three years' average actual loss experience.

**(h) Accrual for financial assistance**

The Corporation recognizes financial assistance to specific credit unions as an expense when the need for financial assistance becomes likely and the amount can reasonably be estimated.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

**NOTE 2 (continued)**

Additionally, an accrual for financial assistance is established by assessing the aggregate risk in the Alberta credit union system based on existing capital available in individual credit unions, current and anticipated market and economic conditions, the likelihood of losses, and the application of historic loss experience. It reflects management's best estimate of the losses arising from the inherent risk in the Alberta credit union system. Future economic conditions are not predictable with certainty and actual losses may vary significantly from management's estimate.

**(i) Fair value of financial instruments**

Most financial instruments are valued at their carrying amounts included on the balance sheet, which are reasonable estimates of fair value. This approach applies to cash, accrued interest receivable, due from credit unions, accounts payable and accrued liabilities, accrual for financial assistance, special contribution payable and long-term unclaimed credit union balances payable. The fair values of investments are disclosed in Note 3.

## NOTE 3 INVESTMENTS

*(thousands)*

| | 2004 Cost | 2004 Market Value[2] | 2003 Cost | 2003 Market Value[2] |
|---|---|---|---|---|
| Securities issued or guaranteed by: | | | | |
| Canada | $ 31,620 | $ 32,856 | $ 37,472 | $ 38,519 |
| Provinces | 19,817 | 20,442 | 17,148 | 17,682 |
| Other[1] | 45,337 | 46,483 | 34,782 | 35,625 |
| Total | $ 96,774 | $ 99,781 | $ 89,402 | $ 91,826 |

1 These securities include shares of Credit Union Central Alberta Limited ($100,000) and Concentra Financial Services Association ($15,000), which approximate market value and have no specific term to maturity.

2 Market value is calculated using independent pricing sources and Canadian investment dealers.

The investment portfolio is managed by external managers with the objective of providing investment returns higher than the total return of the applicable Scotia Capital Markets All-Government indices over a four year period. The portfolio is comprised of high quality Canadian fixed income and debt related instruments. Competitive investment returns are achieved through management of the portfolio duration and holdings.

As at December 31, 2004, securities held have an average effective yield of 4.70% per annum based on cost (2003 - 4.80%); 3.80% per annum based on market (2003 - 4.10%). These securities have the following term structure based on cost: under one year - 2% (2003 - 1%); over one year and under five years - 51% (2003 - 57%); over five years and under ten years - 47% (2003 - 42%).

The market value of the investments is subject to fluctuation as a result of normal market risk. The principle factor influencing the market value is the prevailing rate of interest. An increase of 1 per cent in interest rates will result in a decrease of approximately $963,000 (2003 - $889,000) in the market value of the total investments; and conversely, a decrease of 1 percent in interest rates will result in an increase in the market value of the same amount.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## NOTE 4 OTHER ASSETS

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Prepaid expenses | $ 835 | $ 903 |
| Future income taxes recoverable (Note 9) | 27 | 29 |
| Total | $ 862 | $ 932 |

## NOTE 5 PROPERTY AND EQUIPMENT

*(thousands)*

| | Cost | Amortization | 2004 Net Book Value | 2003 Net Book Value |
|---|---|---|---|---|
| Furniture and equipment | $ 397 | $ 377 | $ 20 | $ 30 |
| Computer equipment | 171 | 116 | 55 | 62 |
| Leasehold improvements | 127 | 97 | 30 | 56 |
| Computer software | 121 | 102 | 19 | 21 |
| Net book value | $ 816 | $ 692 | $ 124 | $ 169 |

## NOTE 6 ACCRUAL FOR FINANCIAL ASSISTANCE

To fulfill the mandate described in Note 1, the Corporation assists Alberta credit unions experiencing financial difficulties when and as required. The Corporation monitors credit unions experiencing financial difficulty and has a contingent responsibility to provide further financial assistance, the amount of which, if any, is undeterminable at this time.

The book value of the accrual for financial assistance approximates its fair value as it represents the Corporation's best estimate of the future amounts to be paid.

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Accrual for financial assistance: | | |
| Balance at beginning of year | $ 1,265 | $ 1,700 |
| Provision for (recovery of) financial assistance | 60 | (435) |
| Balance at end of year | $ 1,325 | $ 1,265 |
| Provision for (recovery of) financial assistance: | | |
| Provision for (recovery of) financial assistance | $ 60 | $ (435) |
| Financial assistance payment | 10 | - |
| Loan loss recoveries | (12) | (10) |
| Provision for (recovery of) financial assistance | $ 58 | $ (445) |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## NOTE 7 SPECIAL CONTRIBUTION PAYABLE

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Balance at beginning of year | $ 9,168 | $ 8,354 |
| Payment of previous year's special contribution | (9,168) | (8,354) |
| Special contribution for the year | 9,972 | 9,168 |
| Balance at end of year | $ 9,972 | $ 9,168 |

A special contribution is an annual amount payable by the Corporation to the Province under the Credit Union Restructuring Agreement until 2010. It is equal to 0.11 per cent of Alberta credit union deposits, including accrued interest and borrowings, as at October 31.

## NOTE 8 COMMITMENTS AND CONTINGENCIES

**(a) Lease commitments**

The Corporation is committed to a non-cancellable operating lease for business premises totalling $161,000 (2003 - $299,000).

The following amounts represent minimum payments over the next two years:

| | |
|---|---|
| 2005 | $ 138,000 |
| 2006 | 23,000 |

**(b) Litigation**

There are legal proceedings pending against the Corporation that arise from normal business activities. Management of the Corporation believes that the financial cost of resolution of these proceedings will not be material to the financial position of the Corporation.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## NOTE 9 INCOME TAXES

The Corporation is a deposit insurance corporation for income tax purposes. Its taxable income excludes assessments and financial assistance recoveries and no deduction may be made for financial assistance, insurance premiums, insurance claims, or special contributions paid.

The Corporation's statutory income tax rate is 17.2% (2003 - 20.1%). Income taxes differ from the expected result that would have been obtained by applying the combined federal and provincial tax rate to income before income taxes, for the following reasons:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Expected income tax expense on pre-tax income at the statutory rate (net of general tax reduction) | $ 1,067 | $ 1,558 |
| Add (deduct) tax effect of: | | |
| Non-taxable assessments | (2,746) | (2,949) |
| Non-deductible special contribution | 1,718 | 1,843 |
| Non-taxable provision for (recovery of) financial assistance | 10 | (89) |
| Non-deductible insurance premiums | 158 | 157 |
| Non-deductible insurance claims | 104 | 17 |
| Other | 2 | 4 |
| Income taxes | $ 313 | $ 541 |

At December 31, 2004 the Corporation had unamortized property and equipment for income tax purposes in excess of related book values of approximately $157,000 (2003 - $171,000). The resulting future income taxes recoverable are reflected in Note 4. The Corporation's future effective income tax rate is 17.2%.

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Current income taxes | $ 311 | $ 528 |
| Future income taxes | 2 | 13 |
| Income taxes | $ 313 | $ 541 |

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

## NOTE 10 DIRECTORS' AND MANAGEMENT REMUNERATION

*(thousands)*

| | Directors Fees or Salary [1] | Other cash Benefits[2] | Other Non Cash Benefits[3] | 2004 Total | 2003 Total |
|---|---|---|---|---|---|
| Chair [4,7] | $ 51 | $ - | $ - | $ 51 | $ 42 |
| Board Members [4,7] | 90 | - | - | 90 | 72 |
| Current senior management: | | | | | |
| President and Chief Executive Officer[5] | $ 166 | $ 25 | $ 37 | $ 228 | $ 207 |
| Vice President, Finance and Administration | 128 | 13 | 23 | 164 | 149 |
| Vice President, Operations | 114 | 11 | 14 | 139 | 122 |
| Vice President, Credit[6] | 101 | 8 | 14 | 123 | 130 |
| Manager, Information Services | 76 | 5 | 12 | 93 | 89 |

1 Salary includes regular base pay.

2 Other cash benefits include bonus payments and accruals.

3 Employer's share of all employee benefits and contributions or payments made on behalf of employees including Canada Pension Plan, Employment Insurance, group Registered Retirement Savings Plan, dental coverage, vision coverage, medical benefits including out of country medical benefits, group life insurance, accidental disability and dismemberment insurance, professional memberships, staff fund, automobile allowances and tuitions.

4 The Chair and Board Members are paid on a per diem basis for preparation and meeting time. The Deputy Minister of Finance is a Board Member but receives no remuneration from the Corporation.

5 The position was occupied by two individuals during the year. The previous incumbent retired May 31, 2004. The new incumbent started March 1, 2004.

6 The position was occupied by two individuals during the year. The previous incumbent was appointed President and Chief Executive Officer on March 1, 2004. The new incumbent started April 1, 2004.

7 The minimum and maximum amounts paid to directors was $4,000 (2003 - $400) and $51,000 (2003 - $42,000) respectively. The average amount paid to directors was $18,000 (2003 - $16,000).

## NOTE 11 2004 BUDGET

The 2004 budget was approved by the Board of Directors on September 22, 2003.

## NOTE 12 COMPARATIVE FIGURES

The 2003 figures have been restated where necessary to conform to 2004 presentation.

CREDIT UNION DEPOSIT GUARANTEE CORPORATION

**SCHEDULE OF ADMINISTRATION EXPENSES** **Schedule 1**

Year Ended December 31, 2004 *(thousands)*

| | Budget | 2004 Actual | 2003 Actual |
|---|---|---|---|
| Deposit Guarantee Fund | | | |
| Salaries and benefits | $ 2,847 | $ 2,742 | $ 2,599 |
| Professional fees | 303 | 177 | 115 |
| Staff travel | 245 | 171 | 149 |
| Rental charges | 171 | 168 | 161 |
| Other | 206 | 100 | 101 |
| Office | 137 | 115 | 97 |
| Board and committee fees | 153 | 141 | 114 |
| Amortization | 135 | 120 | 82 |
| Board and committee expenses | 44 | 43 | 24 |
| | 4,241 | 3,777 | 3,442 |
| Allocation to Master Bond Fund | (120) | (120) | (120) |
| | $ 4,121 | $ 3,657 | $ 3,322 |

# N.A. PROPERTIES (1994) LTD.

## Financial Statements

YEAR ENDED MARCH 31, 2005

AUDITOR GENERAL
*Alberta*

# AUDITOR'S REPORT

**To the Shareholder of N.A. Properties (1994) Ltd.**

I have audited the balance sheet of N.A. Properties (1994) Ltd. as at March 31, 2005 and the statement of operations and deficit for the year then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

N.A. PROPERTIES (1994) LTD.

## BALANCE SHEET

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| Cash (Note 4) | $ 2,568 | $ 2,524 |
| Accounts receivable | 6 | 6 |
| Note receivable (Note 5) | 14 | 12 |
| | $ 2,588 | $ 2,542 |
| **LIABILITIES** | | |
| Obligations under indemnities and commitments (Note 6) | $ 964 | $ 1,102 |
| **SHAREHOLDER'S EQUITY** | | |
| Share capital (Note 7) | 5,769 | 5,769 |
| Deficit | (4,145) | (4,329) |
| | 1,624 | 1,440 |
| | $ 2,588 | $ 2,542 |

On behalf of the Board:

Sole Director - Rod Matheson

## STATEMENT OF OPERATIONS AND DEFICIT

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Revenue** | | |
| Interest and other | $ 64 | $ 77 |
| **Expense** | | |
| General and administrative | 18 | 25 |
| Operating income before provision | 46 | 52 |
| Recovery of (provision for) obligations under indemnities and commitments (Note 6) | 138 | (600) |
| **Excess (deficiency) of revenue over expense for the year** | 184 | (548) |
| **Deficit, beginning of year** | (4,329) | (3,781) |
| **Deficit, end of year** | $ (4,145) | $ (4,329) |

*The accompanying notes are part of these financial statements.*

N.A. PROPERTIES (1994) LTD.

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

*(thousands)*

## NOTE 1 AUTHORITY

N.A. Properties (1994) Ltd. (the "Company") was continued on March 31, 1994 as an amalgamated corporation under the *Business Corporation Act*, Statutes of Alberta 2000, Chapter B-9, as amended. The Province of Alberta owns all issued shares of the Company and accordingly the Company is exempt from income tax.

## NOTE 2 NATURE OF OPERATIONS

The Company's mandate is to dispose of its remaining assets. The Province of Alberta has indemnified the Company for all net losses, expenses or liabilities existing or subsequently incurred by the Company. There were no recoveries from the Province of Alberta in satisfaction of this indemnity in the past three years.

The Company also manages indemnities described in Note 6.

## NOTE 3 SIGNIFICANT ACCOUNTING POLICIES

**(a) Financial Statement Presentation**

A cash flow statement is not provided due to the limited nature of the Commission's operations. All information about the Commission's cash flows are contained within the financial statements.

**(b) Fair Value**

The carrying value of cash and accounts receivable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of other financial assets and liabilities are provided in the applicable notes to the financial statements.

## NOTE 4 CASH

Cash is deposited in the Consolidated Cash Investment Trust Fund which is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004 - 2.11% per annum).

## NOTE 5 NOTE RECEIVABLE

The non-interest bearing note receivable in the amount of $933 was issued in November 1987 and matures in the year 2027. The carrying value of the note receivable as at March 31, 2005 is $14 (2004 - $12). The note receivable is discounted by 20% based on the yield in effect at the time of issuance and adjusting the rate for a risk premium. The fair market value of the note at March 31, 2005 is estimated to be $42 (2004 - $34) using the current interest rate in effect and adjusting the rate for a risk premium.

N.A. PROPERTIES (1994) LTD.

## NOTE 6 INDEMNITIES AND COMMITMENTS

In the past, the Company provided indemnities of principal and interest on mortgages sold to a Canadian chartered bank. The principal and interest on these mortgages totalled $2,058 at March 31, 2005 (2004 - $2,239). The Company's indemnities expire in part in 2015 and in full in 2017. The Company estimates its liability under the indemnities annually, based on its assessment of the mortgages.

Changes in the Company's obligations under indemnities and commitments are as follows.

| | 2005 | 2004 |
|---|---|---|
| Beginning balance | $ 1,102 | $ 502 |
| (Recovery of) provision for obligations under indemnities and commitments | (138) | 600 |
| Ending balance | $ 964 | $ 1,102 |

## NOTE 7 SHARE CAPITAL

Authorized
- Unlimited number of Class "A" voting shares
- Unlimited number of Class "B" voting shares
- Unlimited number of Class "C" non-voting shares
- Unlimited number of Class "D" non-voting shares
- Unlimited number of Class "E" voting shares
- Unlimited number of Class "F" non-voting shares

| | | 2005 | 2004 |
|---|---|---|---|
| Issued | | | |
| 1 | Class "A" share | $ 5,768 | $ 5,768 |
| 1,000 | Class "B" shares | 1 | 1 |
| | | $ 5,769 | $ 5,769 |

## NOTE 8 CONTINGENCIES

The Company has one lawsuit filed by plaintiffs outstanding. Management considers the liability under these legal proceedings not to be determinable and accordingly an estimate of any contingent loss cannot be made.

N.A. PROPERTIES (1994) LTD.

## NOTE 9 RELATED PARTY TRANSACTIONS

Other than interest earned from the Consolidated Cash Investment Trust Fund, there were no other related party transactions in the year ended March 31, 2005.

## NOTE 10 FEES AND SALARIES

There were no director's fees or salaries paid during the year. The Company had no employees in 2005 and 2004.

## NOTE 11 BUDGET

The Company's annual budget appears in the 2004-05 Government and Lottery Fund Estimates. The budget projected a net excess of revenue over expenses for the year of $nil. Since the Company has liquidated almost all of its assets, a detailed budget was not prepared.

# GAINERS INC.

## Financial Statements

YEAR ENDED SEPTEMBER 30, 2004

AUDITOR GENERAL
Alberta

# AUDITOR'S REPORT

**To the Shareholder of Gainers Inc.**

I have audited the consolidated balance sheet of Gainers Inc. as at September 30, 2004 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
May 20, 2005

GAINERS INC.

## CONSOLIDATED BALANCE SHEET

As at September 30, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| Cash | $ 2 | $ 2 |
| Investment in and amount due from former affiliate (Note 2) | - | - |
| | $ 2 | $ 2 |
| **LIABILITIES** | | |
| Accounts payable and accrued liabilities | 211 | 228 |
| Principal and interest on prior years' income taxes (Note 3) | 9,854 | 9,231 |
| Long-term debt (Note 4) | 192,837 | 192,815 |
| | 202,902 | 202,274 |
| **SHAREHOLDER'S DEFICIENCY** | | |
| Share capital (Note 6) | 1 | 1 |
| Deficit | (202,901) | (217,275) |
| Contributed surplus (Note 7) | - | 15,002 |
| | (202,900) | (202,272) |
| | $ 2 | $ 2 |

Approved by the Board of Directors

Dan Harrington

## CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

For the Year Ended September 30, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Expenses** | | |
| Interest on prior years' income taxes | $ 623 | $ 624 |
| General and administrative | 5 | 11 |
| **Net loss for the year** | (628) | (635) |
| **Deficit - beginning of year** | (217,275) | (216,640) |
| | (217,903) | (217,275) |
| **Transfer of contributed surplus (Note 7)** | 15,002 | - |
| **Deficit - end of year** | $ (202,901) | $ (217,275) |

The accompanying notes are part of these consolidated financial statements.

GAINERS INC.

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended September 30, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operating activities** | | |
| Net loss for the year | $ (628) | $ (635) |
| Net change in non-cash working capital items | 606 | 618 |
| | (22) | (17) |
| **Financing activities** | | |
| Proceeds from long-term debt | 22 | 17 |
| **Change in cash** | - | - |
| **Cash, beginning of year** | 2 | 2 |
| **Cash, end of year** | $ 2 | $ 2 |

The accompanying notes are part of these consolidated financial statements.

GAINERS INC.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004 *(thousands)*

## NOTE 1 BASIS OF PRESENTATION

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgement. Actual results could differ from those estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

The consolidated financial statements of the company include the accounts of Gainers Inc. and its wholly owned subsidiary companies: Gainers Properties Inc. (GPI) and MPF Note Inc., collectively the "company".

Through September 25, 1993, the company operated on a going-concern basis, which contemplated the realization of assets and discharge of liabilities in the normal course of business. Events since that date have resulted in the discontinuance of all ongoing business. The company has disposed of its non-monetary assets, with the exception of its investment in Pocklington Corp. Inc. described below. The company is waiting for the determination or settlement of remaining lawsuits before its dissolution.

Any repayment of the long-term debt by the company is expected by management to be immaterial.

## NOTE 2 INVESTMENT IN AND AMOUNTS DUE FROM FORMER AFFILIATES

The investment, which has been written down to $nil value, comprises 77,500 Class A preferred shares of Pocklington Corp. Inc. with a par value of, and which are redeemable at, US $100 per share and which carry annual non-cumulative dividends of US $11 per share. In November 1989, a demand for redemption of the shares was made by Gainers Inc. and an action was commenced against Mr. Pocklington arising from this investment, seeking by way of damages the monies invested together with interest thereon. Mr. Pocklington has counterclaimed seeking statutory indemnification as a director for his actions. Management believes that this counterclaim is without merit.

Advances to the former affiliate, Pocklington Financial Corporation (formerly Pocklington Holdings Inc.), which are recorded at $nil value, are non-interest bearing and have no specific terms of repayment. In January 1990, Gainers Inc. made demand on and brought an action against Pocklington Financial Corporation to recover the advances. In December 1995, a judgment was rendered and collected in favour of Gainers Inc. in the amount of $770. This amount has been recovered by the company from Pocklington Financial Corporation. This amount was subject to the secured claim of the Province as described in Note 4 and was subsequently remitted to the Province of Alberta ("Alberta"). Gainers Inc. appealed this decision to the Alberta Court of Appeal and was successful on all issues. The Court of Appeal ordered that a new calculation of the amount to be repaid be made by the Court of Queen's Bench. Gainers Inc. has not taken further steps as Pocklington Financial Corporation is bankrupt.

GAINERS INC.

**NOTE 2 (continued)**

On August 8, 1989, Gainers Inc. acquired the shares of 350151 Alberta Ltd. (350151) for $100 cash. On October 4, 1989, Gainers Inc., at the direction of the former owner, sold the shares of 350151 to Pocklington Holdings Inc. for $100 cash. Alberta filed a claim to have the sale reversed. The accounts of 350151 are not included in these financial statements. In December 1995, a judgment as to the ownership of the shares was rendered in favour of Pocklington Financial Corporation. Alberta appealed this decision, and on November 21, 2000 the Alberta Court of Appeal reversed the 1995 judgment. The Court of Appeal has held that the purported sale of the shares of 350151 to Pocklington Holdings Inc. on October 4, 1989 was a breach of the Master Agreement (Note 4) and awarded $4,700 in damages plus trial and appeal costs of Alberta against Mr. Pocklington. This judgement was subsequently paid from realizing on collateral security held for the debt.

## NOTE 3 INCOME TAXES

The prior years' liability for income taxes plus accrued interest is an unsecured debt. The long-term debt owed to Alberta is a secured debt and thus ranks in priority. It is considered highly unlikely that the company will be able to settle this liability for income taxes and interest as the amount owing to Alberta exceeds the amount, which is reasonably expected to be recovered from the remaining assets of the company.

The company has capital and non-capital income tax losses available for carry forward to reduce taxable income of future years. The amount of capital losses available for carry forward is $54,491. The amount of non-capital losses available for carry forward is $2,186. These non-capital losses expire as follows:

| | |
|---|---|
| 2005 | $ 1,983 |
| 2006 | 100 |
| 2007 | 32 |
| 2008 | 38 |
| 2009 | 17 |
| 2010 | 11 |
| 2011 | 5 |
| | $ 2,186 |

GAINERS INC.

## NOTE 4 LONG-TERM DEBT

| | 2004 | 2003 |
|---|---|---|
| **Province of Alberta** | | |
| Term loan | $ 6,000 | $ 6,000 |
| Assignment of prior operating loans from previous banker | | |
| Term bank loan (US $8,749) | 11,567 | 11,567 |
| Operating loan | 20,979 | 20,979 |
| Advances under guarantee for principal and interest payments | 31,947 | 31,947 |
| Promissory note | 42,846 | 42,846 |
| Advance to facilitate sale | 13,000 | 13,000 |
| Advances under guarantee and indemnity for operating line | 18,469 | 18,469 |
| Default costs and guarantee fees | 13,538 | 13,516 |
| Accrued interest | 34,491 | 34,491 |
| | $ 192,837 | $ 192,815 |

The fair value of the long-term debt is dependent on outcomes from claims filed by or against Gainers Inc. Due to the uncertainty of these items, the fair value as at September 30, 2004 is estimated to be $nil.

**Province of Alberta**

On September 25, 1987, Gainers Inc. and GPI entered into the Master Agreement with Alberta, which provided for a term loan facility and a loan guarantee. Pursuant to the Master Agreement, Gainers Inc. and GPI granted securities to 369413 Alberta Ltd. (Nominee) which holds the securities and loans, as later described in this Note, in trust for Alberta. A number of events of default, which still continue, occurred during 1989, resulting in the long-term debt and liability to Alberta becoming due and payable. Alberta acted on its security and, on October 6, 1989, took control of Gainers Inc.'s issued and outstanding shares, which previously were controlled by Mr. Pocklington.

On October 6, 1989, operating loans of $20,979 and, a term loan of US $8,749 were purchased, transferred and assigned to the Nominee. In addition, Alberta has made payments since October 6, 1989 under the guarantee to cover principal and interest payments due, including the purchase in December 1993 of the balance due under the promissory note made by GPI to Yasuda Mutual Life Assurance Company.

**Interest**

The interest on the loans and other indebtedness owing to Alberta has not been paid in accordance with the terms of the indebtedness. Effective February 5, 1994, Alberta declared all indebtedness owing by the company to Alberta to be non-interest bearing from the later of February 5, 1994 and the date the indebtedness to the Province of Alberta was incurred.

GAINERS INC.

**NOTE 4 (continued)**

**Security**

Collateral security for the indebtedness to Alberta includes a general assignment of book debts, general security agreements over all real and personal property of the company, a pledge of inventory, and fixed and floating charge debentures amounting to $70,000 covering all of the assets of the company. The company continues to be in default and in breach of certain covenants of this indebtedness.

**Master Agreement**

The Master Agreement provided for Alberta to advance a term loan to GPI in the aggregate amount of $12,000. As at September 30, 1989, $6,000 of the term loan had been advanced. An interest payment due on October 1, 1989 was not made and Alberta, acting on its security, seized control of the company. Since default has occurred under the Master Agreement, the entire amount of the monies advanced for the term loan is due and owing by GPI to Alberta. The term loan which has been advanced, and interest thereon, and the performance and observance of the other covenants of GPI under the Master Agreement, including the obligations of GPI to the Nominee in the principal sum of $67,000 dated September 25, 1987 and constituting a fixed mortgage and charge over all of the real property, equipment and chattels of GPI and a floating charge over all of the undertaking and other property and assets of GPI, and by a pledge by GPI of preferred shares held by GPI in Gainers Inc.

## NOTE 5 CONTINGENCIES

a) The company and Alberta have filed claims against Mr. Pocklington and companies controlled by him for recovery of certain loans, payments and other transactions prior to October 6, 1989. The claim aggregates approximately $38,000 plus interest. Ultimate recovery of this claim cannot be determined at this time.

b) Under the terms of the Master Agreement, the company and Mr. Pocklington are liable for all losses, expenses, costs and claims incurred by Alberta as a consequence of a default by the company, as defined in Note 1, or by Mr. Pocklington. As a result, since the date of default the company has incurred approximately $14,084 (net of repayments) in the consolidated financial statements for these costs and expenses. It is expected that further costs and expenses will be incurred in the future as a result of continuing default. Ultimate recovery of this claim cannot be determined at this time.

c) Alberta has brought a claim against Mr. Pocklington for damages arising out of breaches by him of the Master Agreement or alternatively, negligent misrepresentations made by him in certificates sworn by him in 1988 and 1989, which caused the Crown to make advances under the Term Loan.

GAINERS INC.

**NOTE 5 (continued)**

Mr. Pocklington has brought a counterclaim against the company in which Mr. Pocklington claims indemnification for the entire amount of the main claim.

Alberta obtained summary judgment in the amount of $7,257 in respect of one of the certificates sworn by Mr. Pocklington in 1988. The judgment has been appealed by Mr. Pocklington.

## NOTE 6 SHARE CAPITAL

Authorized:

- Unlimited number of Class A common shares
- Unlimited number of Class B preferred shares redeemable/retractable at $1 per share with non-cumulative annual dividends at a rate not exceeding 16% of the redemption value.
- 12,000,000 Class C preferred shares redeemable at $1 per share with cumulative annual dividend compounded semi-annually at 9.6% of the redemption price.

Issued:

| | 2004 | 2003 |
|---|---|---|
| 101 Class A common shares | $ 1 | $ 1 |
| 6,000,000 Class C preferred shares | 6,000 | 6,000 |
| | 6,001 | 6,001 |
| Less: 6,000,000 Class C preferred shares held by GPI | 6,000 | 6,000 |
| | $ 1 | $ 1 |

## NOTE 7 TRANSFER OF CONTRIBUTED SURPLUS

Contributed surplus has been transferred to deficit because the purposes for which the contributions were made have either been achieved or are no longer relevant because of the company's dormant status.

GAINERS INC.

## NOTE 8 FINANCIAL INSTRUMENTS

The fair value of accounts payable and accrued liabilities and principal and interest on prior years' income taxes has not been estimated as management cannot reasonably estimate when the amount will be paid. The fair value of long-term debt is estimated to be nil (see Note 4).

## NOTE 9 COMPARATIVE FIGURES

The comparative figures are based upon financial statements which were reported on by another auditor.

# SUPPLEMENTARY INFORMATION REQUIRED BY LEGISLATION OR BY DIRECTION OF THE MINISTER OF FINANCE

## Statement of Remissions, Compromises and Write-Offs

For the year ended March 31, 2005

The following statement has been prepared pursuant to section 23 of the *Financial Administration Act*. The statement includes all write-offs of the Ministry of Finance made or approved during the fiscal year. There were no compromises.

| | |
|---|---|
| WRITE-OFFS | |
| Department of Finance | |
| Implemented guarantees and indemnities | |
| Gainers Inc. and subsidiaries | $ 11,859 |
| Small Business Term Assistance Act loans | 3,975 |
| | 15,834 |
| Accounts and interest receivable | |
| Corporate income tax | 1,830,012 |
| Hotel tax | 25,418 |
| Fuel tax | 6,982 |
| | 1,862,412 |
| Alberta Treasury Branches | |
| Loans and accounts receivable | 22,982,000 |
| | $ 24,860,246 |
| REMISSIONS | |
| Tobacco tax theft claims | $ 12,829 |
| | $ 24,873,075 |

SUPPLEMENTARY INFORMATION REQUIRED BY LEGISLATION

## STATEMENT OF BORROWINGS MADE UNDER SECTION 56(1) OF THE FINANCIAL ADMINISTRATION ACT

For the year ended March 31, 2005

The following statement has been prepared pursuant to section 56(2) of the *Financial Administration Act*.

| | Issue Principal | Proceeds |
|---|---|---|
| Payable in Canadian dollars: | | |
| Promissory notes | $ 5,265,000,000 | $ 5,258,729,710 |

## STATEMENT OF THE AMOUNT OF DEBT OF THE CROWN FOR WHICH SECURITIES WERE PLEDGED

The following statement has been prepared pursuant to section 66(2) of the *Financial Administration Act*.

The amount of the debt of the Crown outstanding at the end of the 2004-05 fiscal year for which securities were pledged under Part 6 of the Financial Administration Act was $Nil.

## STATEMENT OF GUARANTEES AND INDEMNITIES

For the year ended March 31, 2005 *(thousands)*

The following statement has been prepared pursuant to section 75 of the *Financial Administration Act*. The statement summarizes the amounts of all guarantees and indemnities given by the Ministry of Finance on behalf of the Crown and Provincial corporations for the year ended March 31, 2005, the amounts paid as a result of liability under guarantees and indemnities, and the amounts recovered on debts owing as a result of payments under guarantees and indemnities.

| Program/Borrower | Guarantee or Indemnity | Payments | Recoveries |
|---|---|---|---|
| CROWN GUARANTEES | | | |
| Gainers Inc. and subsidiaries | $ - | $ 11,859 | $ - |
| Rural utilities loans | - | 3,975 | - |
| | - | 15,834 | - |
| CROWN INDEMNITIES | | | |
| Native residential school litigation indemnity payments recoverable from Department of Education | - | 15,960 | 15,960 |
| | $ - | $ 31,794 | $ 15,960 |

# LOCAL AUTHORITIES PENSION PLAN

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Local Authorities Pension Plan Board of Trustees**

I have audited the Statement of Net Assets Available for Benefits and Accrued Benefits of the Local Authorities Pension Plan (the Plan) as at December 31, 2004 and the Statements of Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits and Accrued Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
March 7, 2005

LOCAL AUTHORITIES PENSION PLAN

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND ACCRUED BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Investments (Note 3) | $ 10,806,190 | $ 9,642,129 |
| Contributions receivable (Note 6) | 21,280 | 15,774 |
| Accrued investment income and accounts receivable | 3,844 | 4,136 |
| | 10,831,314 | 9,662,039 |
| Liabilities | | |
| Accounts payable | 3,838 | 6,726 |
| Net assets available for benefits | 10,827,476 | 9,655,313 |
| **Accrued Benefits** | | |
| Actuarial value of accrued benefits | 12,116,400 | 11,108,800 |
| **Deficiency (Notes 11 and 12)** | $ (1,288,924) | $ (1,453,487) |

*See accompanying notes and schedules.*

LOCAL AUTHORITIES PENSION PLAN

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in assets** | | |
| Contributions (Note 7) | $ 602,436 | $ 459,338 |
| Net investment income (Note 8) | 1,017,321 | 1,155,698 |
| Net transfer from the Public Service Pension Plan | - | 13,935 |
| | 1,619,757 | 1,628,971 |
| **Decrease in assets** | | |
| Pension benefits | 373,218 | 343,733 |
| Refunds to members | 52,686 | 43,625 |
| Transfers to other plans | 4,578 | 541 |
| Plan expenses (Note 9) | 17,112 | 17,079 |
| | 447,594 | 404,978 |
| **Increase in net assets** | 1,172,163 | 1,223,993 |
| **Net assets available for benefits at beginning of year** | 9,655,313 | 8,431,320 |
| **Net assets available for benefits at end of year** | $ 10,827,476 | $ 9,655,313 |

*See accompanying notes and schedules.*

LOCAL AUTHORITIES PENSION PLAN

## STATEMENT OF CHANGES IN ACCRUED BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in accrued benefits** | | |
| Interest accrued on benefits | $ 788,900 | $ 754,200 |
| Benefits earned | 520,800 | 479,100 |
| Net experience losses and other changes (Note 10 (a)) | 133,300 | 96,400 |
| Changes in actuarial assumptions (Note 10 (a)) | (9,200) | 131,800 |
| Net transfer from the Public Service Pension Plan | - | 11,700 |
| | 1,433,800 | 1,473,200 |
| **Decrease in accrued benefits** | | |
| Benefits paid including interest | 426,200 | 401,300 |
| **Net increase in accrued benefits** | 1,007,600 | 1,071,900 |
| **Accrued benefits at beginning of year** | 11,108,800 | 10,036,900 |
| **Accrued benefits at end of year (Note 10)** | $ 12,116,400 | $ 11,108,800 |

## STATEMENT OF CHANGES IN DEFICIENCY

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Deficiency at beginning of year (Notes 11 and 12)** | $ (1,453,487) | $ (1,605,580) |
| Increase in net assets available for benefits | 1,172,163 | 1,223,993 |
| Net increase in accrued benefits | (1,007,600) | (1,071,900) |
| **Deficiency at end of year (Notes 11 and 12)** | $ (1,288,924) | $ (1,453,487) |

*See accompanying notes and schedules.*

LOCAL AUTHORITIES PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Local Authorities Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000 and Alberta Regulation 366/93, as amended.

**(a) General**

The Plan is a contributory defined benefit pension plan for eligible employees of local authorities and approved public bodies. These include cities, towns, villages, municipal districts, hospitals, regional health authorities, school divisions, districts, colleges, technical institutes and certain commissions, foundations, agencies, libraries, corporations, associations and societies. The Plan is a registered pension plan as defined in the *Income Tax Act*. The Plan's registration number is 0216556.

**(b) Funding Policy**

Current service costs and the Plan's actuarial deficiency (see Note 12) are funded by employers and employees at rates which together with investment earnings are expected to provide for all benefits payable under the Plan. The contribution rates for employers are 1.0% more than the rates for employees. The rates in effect at December 31, 2004 were 5.602% (2003 4.525%) of pensionable earnings up to the Canada Pension Plan's Year's Maximum Pensionable Earnings (YMPE) and 7.477% (2003 6.40%) of the excess for employees, and 6.602% (2003 5.525%) of pensionable earnings up to the YMPE and 8.477% (2003 7.40%) of the excess for employers.

The rates were reviewed by the Board in 2004 and are to be reviewed at least once every three years based on recommendations of the Plan's actuary. As a result of this review, the rates have increased at January 1, 2005 as follows: 6.40% of pensionable earnings up to the YMPE and 9.14% of the excess for employees, and 7.40% of pensionable earnings up to the YMPE and 10.14% of the excess for employers.

**(c) Retirement Benefits**

The Plan provides for a pension of 1.4% for each year of pensionable service based on the average salary of the highest five consecutive years up to the YMPE and 2.0% on the excess, subject to the maximum benefit limit allowed under the federal Income Tax Act. The maximum service allowable under the Plan is 35 years. Unreduced pensions are payable to members at retirement who have attained age 65, or have attained age 55 and the sum of their age and years of service equals 85. Reduced pensions are payable to members at age 55 or older retiring early with a minimum of two years of service.

**(d) Disability Benefits**

Pensions are payable to members who become totally disabled and retire early with at least two years of membership. Reduced pensions are payable to members who become partially disabled and retire early with at least two years of membership.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 1 (continued)**

**(e) Death Benefits**

Death benefits are payable on the death of a member. If the member has at least two years of service, a surviving pension partner may choose to receive a survivor pension. For a beneficiary other than a pension partner, or where service is less than two years, a lump sum payment must be chosen.

**(f) Termination Benefits**

Members who terminate with at least two years of membership and who are not immediately entitled to a pension may transfer out the commuted value for all earned service, contributions paid in respect of optional service with interest, plus excess contributions if applicable, which is subject to lock-in provisions. Alternatively, they may elect to receive a deferred pension. Members who terminate with fewer than two years of membership receive a refund of their contributions and interest.

**(g) Optional Service and Reciprocal Transfers**

All optional service purchases are to be cost-neutral to the Plan.

Transferred-in service will be on an actuarial reserve basis and transfers out will receive the greater of the termination benefits or commuted value for all service.

**(h) Cost-of-Living Adjustments**

Pensions payable are increased each year on January 1st by an amount equal to 60% of the increase in the Alberta Consumer Price Index. The increase is based on the increase during the twelve-month period ending on October 31st in the previous year. This calculation method has been set out in the Plan regulations since 1993.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist Plan members and others in reviewing the activities of the Plan for the year.

Except for real rate of return bonds which are held directly by the Plan, Plan investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Plan or by pooled investment funds are explained in the following paragraphs:

LOCAL AUTHORITIES PENSION PLAN

**NOTE 2 (continued)**

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

The fair value of alternative investments including absolute return strategy investments, investments in private investment funds, private equities and securities with limited marketability is estimated by Alberta Finance or external managers appointed by Alberta Finance using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Real estate investments are reported at their most recent appraised value net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange except for hedged foreign currency transactions, which are translated at rates of exchange established by the terms of the forward exchange contracts. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

LOCAL AUTHORITIES PENSION PLAN

**NOTE 2 (continued)**

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's actuarial value of accrued benefits and in the valuation of the Plan's alternative investments. Uncertainty arises because the Plan's actual experience may differ significantly from assumptions used in the calculation of the Plan's accrued benefits and the estimated fair values of the Plan's alternative investments may differ significantly from the values that would have been used had a ready market existed for these investments.

While best estimates have been used in the calculation of the Plan's accrued benefits and in the valuation of the Plan's alternative investments, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are disclosed as assumption or other changes and net experience gains or losses in the statement of changes in accrued benefits in the year when actual results are known. Differences between the estimated fair values and the amount ultimately realized are included in net investment income in the year when the ultimate realizable values are known.

LOCAL AUTHORITIES PENSION PLAN

## NOTE 3 INVESTMENTS (SCHEDULES A TO E)

*(thousands)*

| | 2004 Fair Value | % | 2003 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 201,544 | 1.9 | $ 192,643 | 2.0 |
| Canadian Dollar Public Bond Pool (b) | 1,635,308 | 15.1 | 1,380,104 | 14.3 |
| Canadian Long Term Government Bond Pool (b) | 1,074,793 | 9.9 | 885,240 | 9.2 |
| Real rate of return bonds (c) | 514,088 | 4.8 | 466,570 | 4.8 |
| Private Mortgage Pool (d) | 279,928 | 2.6 | 259,381 | 2.7 |
| External Managers Currency Alpha Pool (e) | 18,684 | 0.2 | - | - |
| Total fixed income securities | 3,724,345 | 34.5 | 3,183,938 | 33.0 |
| **Canadian Equities (Schedule B)** | | | | |
| External Managers | | | | |
| Canadian Large Cap Equity Pool (f) | 1,609,711 | 14.9 | 1,489,361 | 15.5 |
| Canadian Small Cap Equity Pool (f) | 452,090 | 4.2 | 339,307 | 3.5 |
| Domestic Passive Equity Pooled Fund (g) | 391,829 | 3.6 | 361,090 | 3.7 |
| Private Equity Pool (h) | 11,007 | 0.1 | 13,627 | 0.1 |
| Canadian Pooled Equities Fund | - | - | 147,157 | 1.5 |
| | 2,464,637 | 22.8 | 2,350,542 | 24.3 |
| **United States Equities (Schedule C)** | | | | |
| External Managers | | | | |
| US Small/Mid Cap Equity Pool (i) | 407,249 | 3.8 | 282,011 | 2.9 |
| US Large Cap Equity Pool (i) | 230,739 | 2.1 | 592,647 | 6.2 |
| US Passive Equity Pooled Fund (j) | 476,606 | 4.4 | 514,494 | 5.3 |
| Portable Alpha US Pool (k) | 138,530 | 1.3 | - | - |
| | 1,253,124 | 11.6 | 1,389,152 | 14.4 |
| **Non-North American Equities (Schedule D)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (l) | 985,686 | 9.1 | 1,009,390 | 10.5 |
| EAFE Plus Equity Pool (l) | 459,132 | 4.3 | 435,483 | 4.5 |
| EAFE Emerging Markets (m) | 112,398 | 1.0 | - | - |
| EAFE Passive Equity Pool | - | - | 12,087 | 0.1 |
| EAFE Structured Equity Pooled Fund (n) | 356,311 | 3.3 | 345,684 | 3.6 |
| | 1,913,527 | 17.7 | 1,802,644 | 18.7 |
| **Alternative Investments - Equities** | | | | |
| External Managers | | | | |
| Absolute Return Strategy Pool (o) | 480,348 | 4.5 | 275,909 | 2.9 |
| Private Income Pool (p) | 87,870 | 0.8 | 5,646 | 0.1 |
| Foreign Private Equity Pool (p) | 36,610 | 0.3 | 22,241 | 0.2 |
| | 604,828 | 5.6 | 303,796 | 3.2 |
| Total equities | 6,236,116 | 57.7 | 5,846,134 | 60.6 |
| **Real Estate (Schedule E)** | | | | |
| Private Real Estate Pool (q) | 845,729 | 7.8 | 612,057 | 6.4 |
| **Total investments** | $ 10,806,190 | 100.0 | $ 9,642,129 | 100.0 |

LOCAL AUTHORITIES PENSION PLAN

**NOTE 3 (continued)**

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

(b) The Canadian Dollar Public Bond Pool (CDPB) and the Canadian Long Term Government Bond Pool (CLGB) are managed with the objectives of providing competitive returns comparable to the total returns of the Scotia Capital Universe Bond Index and the Scotia Capital Long Term All Government Bond Index respectively over a four-year period while maintaining adequate security and liquidity of participants' capital. The CDPB portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives while the CLGB portfolio invests only in high quality fixed income instruments of the federal, provincial and municipal governments of Canada. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) Real rate of return bonds are issued or guaranteed by the Government of Canada and bear interest at a fixed rate adjusted for inflation.

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. To limit investment risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(e) The External Managers Currency Alpha Pool is managed with the objective of providing a fair return over a four-year period while reducing return volatility through multiple manager investment style and strategies. The return is achieved through active currency management with currency positions established primarily through forward foreign exchange contracts. Participants deposit into the Pool a modest amount of cash to minimize rebalancing of cash flows in or out of the Pool when the forward foreign exchange contracts settle.

(f) The External Managers Canadian Large Cap and Small Cap Equity Pools consist of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap or small cap equity markets. The Small Cap Pool is restricted to invest in publicly traded Canadian equities with a market capitalization of up to 0.15% of the Toronto Stock Exchange S&P/TSX Composite Index total market capitalization at time of purchase. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

(g) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(h) The Private Equity Pool is in the process of orderly liquidation.

(i) The External Managers US Small/Mid Cap Equity Pool consists of a single portfolio and the External Managers US Large Cap Equity Pool consists of multiple portfolios of publicly traded United States equities. Each portfolio is actively managed by an external manager with expertise in the US small/mid cap or large cap equity markets. The performance objective is to provide returns higher than the total return of the Russell 2500 Index for the US Small/Mid Cap Pool and the Standard & Poor's (S&P) 500 Index for the US Large Cap Pool over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 3 (continued)**

(j) The US Passive Equity Pooled Fund consists of a single portfolio of publicly traded United States equities similar in weights to the S&P 500 Index. The Pooled Fund is managed internally. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. To enhance investment returns with no substantial increase in risks, the Pooled Fund also invests in futures, swaps and other structured investments.

(k) The Portable Alpha US Pool provides exposure to the United States equity market by replicating the S&P 500 Index with S&P 500 index swaps and futures contracts. Externally managed absolute return strategy investments and money market instruments are actively used as underlying securities to add value to the exposure. The performance objective is to provide returns higher than the S&P 500 Index over the long term.

(l) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each Core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

(m) The External Managers Emerging Markets Equity Pool consists of a single portfolio of publicly traded equities in emerging markets around the world. The portfolio is actively managed by an external manager with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International Emerging Markets Free (MSCI EMF) Index over a four-year period.

(n) The EAFE Structured Equity Pooled Fund's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The Pooled Fund is internally managed and provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

(o) The External Managers Absolute Return Strategy Pool is managed by external managers with the objective of providing investment returns comparable to the Consumer Price Index plus 6%. The pool is intended to yield absolute positive investment returns with low volatility using various investment strategies.

(p) The Foreign Private Equity Pool (FPEP) and the Private Income Pool (PIP) are managed with the objectives of providing investment returns comparable to the Consumer Price Index plus 8% and the Consumer Price Index plus 6% respectively. The FPEP invests in institutionally sponsored international private equity pools managed by experienced advisors with proven records. The PIP invests in infrastructure related projects that are structured to yield high current income. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool.

(q) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediate companies, which have issued to the pool common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Plan are primarily affected by the long-term real rate of return expected to be earned on investments. The expected rate of return on investments, together with the expected long term inflation rate, form the basis for determining the economic assumptions used in calculating the actuarial liabilities. In order to earn the best possible return at an acceptable level of risk, the Board of Trustees established a benchmark policy asset mix of 35% fixed income instruments, 55% equities and 10% real estate. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to enhance returns and manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 5 (continued)**

The following is a summary of the Plan's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at December 31, 2004:

*(thousands)*

| | Maturity Under 1 Year | Maturity 1 to 3 Years | Maturity Over 3 Years | 2004 Notional Amount | 2004 Net Fair Value (a) | 2003 Notional Amount | 2003 Net Fair Value (a) |
|---|---|---|---|---|---|---|---|
| | | % | | | | | |
| Equity index swap contracts | 70 | 30 | - | $ 1,169,391 | $ 46,180 | $ 1,084,225 | $ 44,356 |
| Forward foreign exchange contracts | 100 | - | - | 1,002,233 | 22,595 | 347,322 | 10,347 |
| Interest rate swap contracts | 41 | 54 | 5 | 438,515 | (16,936) | 500,737 | (24,618) |
| Cross-currency interest rate swap contracts | 25 | 29 | 46 | 411,079 | (19,260) | 370,966 | (37,345) |
| Credit default swap contracts | 20 | 22 | 58 | 113,565 | 412 | 19,781 | (242) |
| Equity index futures contracts | 100 | - | - | 37,723 | 3,450 | 14,321 | 1,744 |
| Bond index swap contracts | 100 | - | - | 31,880 | 619 | 22,227 | 32 |
| | | | | $ 3,204,386 | $ 37,060 | $ 2,359,579 | $ (5,726) |

(a) The method of determining fair value of derivative contracts is described in Note 2 (e).

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

## NOTE 6 CONTRIBUTIONS RECEIVABLE

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Employers | $ 11,399 | $ 8,493 |
| Employees | 9,881 | 7,281 |
| | $ 21,280 | $ 15,774 |

LOCAL AUTHORITIES PENSION PLAN

## NOTE 7 CONTRIBUTIONS

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Current and optional service | | |
| Employers | $ 316,894 | $ 245,759 |
| Employees (a) | 279,614 | 212,771 |
| Transfers from other plans | 5,928 | 808 |
| | $ 602,436 | $ 459,338 |

(a) Includes $12,135,000 (2003 $9,205,000) of optional service contributions.

## NOTE 8 NET INVESTMENT INCOME

Net investment income is comprised of the following:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Net realized and unrealized gains on investments, including those arising from derivative transactions | $ 681,553 | $ 855,074 |
| Interest income | 222,593 | 192,952 |
| Dividend income | 87,923 | 84,258 |
| Real estate income | 38,958 | 32,395 |
| Securities lending income | 2,616 | 2,510 |
| Pooled funds management and associated custodial fees (Note 9) | (16,322) | (11,491) |
| | $ 1,017,321 | $ 1,155,698 |

The following is a summary of the Plan's proportionate share of net investment income by type of investments:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Fixed Income Securities | $ 334,794 | $ 236,997 |
| Canadian Equities | 328,429 | 486,980 |
| Foreign Equities | | |
| United States | 51,023 | 128,401 |
| Non-North American | 209,153 | 242,093 |
| Alternative Investments - Equities | 22,071 | 6,902 |
| Real Estate | 71,851 | 54,325 |
| | $ 1,017,321 | $ 1,155,698 |

LOCAL AUTHORITIES PENSION PLAN

**NOTE 8 (continued)**

The following is a summary of the investment performance results attained by the Plan:

| | One Year Return | Four-Year Compound Annualized Return | Eight-Year Compound Annualized Return |
|---|---|---|---|
| **Time-weighted rates of return*** | | | |
| Overall Plan | 10.4% | 3.2% | 6.6% |
| Policy Benchmark** | 10.7% | 3.0% | 6.7% |

* The measure involves the calculation of the net return realized by the Plan over a specified period and is a measure of the total proceed received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains and losses (realized and unrealized).

** The policy benchmark return is a product of the weighted average policy sector weights and sector returns.

## NOTE 9 PLAN EXPENSES

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| General administration costs | $ 14,022 | $ 11,356 |
| Investment management costs | 1,857 | 1,752 |
| LAPP Corporation costs | 600 | 501 |
| Actuarial fees | 356 | 208 |
| Process improvements costs | 277 | 337 |
| Mosaic (APEX) project costs | - | 2,925 |
| | $ 17,112 | $ 17,079 |

General administration costs and process improvement costs, including Plan Board costs (see Note 13) were paid to Alberta Pensions Administration Corporation on a cost-recovery basis.

Investment management costs were paid to Alberta Finance on a cost recovery basis to manage the Plan's investment portfolio. Pooled funds management and associated custodial fees totalling $16,322,000 (2003 $11,491,000) (see Note 8), which have been included in calculating net investment income, are excluded from plan expenses.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 9 (continued)**

LAPP Corporation costs include remuneration to senior officials of Local Authorities Pension Plan Corporation as follows:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Chief Executive Officer | | |
| Salary and bonus | $ 187.0 | $ 185.0 |
| Benefits | 17.7 | 8.1 |
| Director, Pension Policy | | |
| Salary and bonus | 125.5 | 111.2 |
| Benefits | 9.3 | 7.3 |
| | $ 339.5 | $ 311.6 |

Total Plan expenses, including pooled funds management and associated custodial fees amounted to $222 per member (2003 $197 per member).

Pooled funds management and associated custodial fees amounted to $109 per member (2003 $79 per member). These expenses, which have been deducted in arriving at net investment income of the pools, are included in the determination of investment returns for the Plan (see Note 8).

Total Plan expenses including pooled funds management and associated custodial fees amounted to 0.31% (2003 0.30%) of assets under administration.

## NOTE 10 ACCRUED BENEFITS

### (a) Actuarial Valuation

An actuarial valuation of the Plan was carried out as at December 31, 2003 by Mercer Human Resource Consulting and was then extrapolated to December 31, 2004. The 2003 valuation was completed after the financial statements of the Plan for 2003 were released. As a result, the differences between the actuarial valuation results and extrapolation results for 2003 are accounted for as change in actuarial assumptions, net experience losses and other changes in 2004.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 10** **(continued)**

The following is a summary of net experience losses and other changes as revealed in the 2003 valuation and reported in 2004:

| | ($ thousands) |
|---|---|
| Higher than expected cost-of-living increase in pension benefit payments | $ 67,400 |
| Retirement experience was less favourable than assumed | 40,300 |
| Termination and mortality experiences were less favourable than assumed | 15,000 |
| Other | 10,600 |
| | $ 133,300 |

Actuarial valuations were determined using the projected benefit method pro-rated on service. The assumptions used in the actuarial valuations and extrapolations were developed as the best estimates of expected market conditions and other future events. These estimates were, after consultation with the Plan's actuary, approved by the Board of Trustees.

The major assumptions used were:

| | 2003 Valuation and 2004 Extrapolation % | 2002 Valuation and 2003 Extrapolation % |
|---|---|---|
| Investment rate of return | 6.70 | 7.00 |
| Inflation rate | 2.75 | 3.25 |
| Salary escalation rate* | 3.50 | 4.00 |

* In addition to merit and promotion.

The Board of Trustees has authorized a policy to have an actuarial valuation of the Plan carried out every year. As a result, an actuarial valuation of the Plan as at December 31, 2004 will be carried out subsequent to the completion of these financial statements. Any differences between the actuarial valuation results and extrapolation results as reported in these financial statements will affect the financial position of the Plan and will be accounted for as gains or losses in 2005.

LOCAL AUTHORITIES PENSION PLAN

**NOTE 10 (continued)**

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation and extrapolation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's deficiency and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2004:

| | Sensitivities | | |
|---|---|---|---|
| | **Changes in Assumptions %** | **Increase in Plan Deficiency ($ million)** | **Increase in Current Service Cost as a % of Pensionable Earnings *** |
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 808 | 0.6% |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 508 | 0.7% |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant | (1.0%) | 1,915 | 2.3% |

* The current service cost as a % of pensionable earnings as determined by the December 31, 2003 valuation was 11.5%

## NOTE 11 FUNDING VALUATION AND EXTRAPOLATION

The Plan's deficiency is determined on the fair value basis for accounting purposes. For funding valuation and extrapolation purposes, asset values are adjusted for fluctuations in fair values to moderate the effect of market volatility on the Plan's funded status. Actuarial asset value for funding valuation and extrapolation purposes amounted to $10,384 million at December 31, 2004 (2003 $9,698 million).

In accordance with the *Public Sector Pension Plans Act*, the actuarial deficiency of $1,535 million as determined by an actuarial funding valuation as at December 31, 2003 is funded by a special payment of 3.60% of pensionable earnings shared equally between employers and employees. The special payment is included in the rates in effect at January 1, 2005 (see Note 1(b)).

LOCAL AUTHORITIES PENSION PLAN

## NOTE 12 CHANGE IN ACCOUNTING POLICY

In order to eliminate any misunderstanding about the actual financial position of the Plan, in 2004, the Board of Trustees introduced a change in accounting policy and assets are now valued on the fair value basis for accounting purposes with no smoothed value reported.

As at December 31, 2004, this change in accounting policy has the effect of decreasing the Plan's deficiency by $444 million. If the change had not been made, the Plan's deficiency would have been $1,733 million as at December 31, 2004.

This change in accounting policy has been applied retroactively and the Plan's deficiencies at December 31, 2002 and 2003 have been restated. The effect of this change in accounting policy is to increase retroactively the Plan's deficiency by $1,161 million at December 31, 2002 and by $43 million at December 31, 2003.

## NOTE 13 REMUNERATION OF BOARD MEMBERS

Remuneration paid with respect to a total of 14 Board members during the year amounted to $116,000 (2003 $92,000).

## NOTE 14 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2004 presentation.

LOCAL AUTHORITIES PENSION PLAN

# SCHEDULES TO THE LOCAL AUTHORITIES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 232,295 | $ 201,514 |
| **Fixed income securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 1,381,985 | 1,263,082 |
| Provincial | | |
| Alberta, direct and guaranteed | 1,033 | 1,055 |
| Other, direct and guaranteed | 1,010,546 | 640,775 |
| Municipal | 29,843 | 29,306 |
| Corporate | 637,474 | 645,709 |
| Private | | |
| Corporate | 414,938 | 394,483 |
| | 3,475,819 | 2,974,410 |
| Receivable from sale of investments and accrued investment income | 29,574 | 24,911 |
| Liabilities for investment purchases | (13,343) | (16,897) |
| | 16,231 | 8,014 |
| | $ 3,724,345 | $ 3,183,938 |

(a) Fixed income securities held as at December 31, 2004 had an average effective market yield of 4.25% per annum (2003 4.63% per annum). The following term structure of these securities as at December 31, 2004 was based on principal amount.

| | 2004 | 2003 |
|---|---|---|
| | % | |
| under 1 year | 2 | 2 |
| 1 to 5 years | 21 | 22 |
| 6 to 10 years | 22 | 22 |
| 11 to 20 years | 18 | 16 |
| over 20 years | 37 | 38 |
| | 100 | 100 |

LOCAL AUTHORITIES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES — Schedule B

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 34,374 | $ 33,896 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 223,567 | 202,250 |
| Consumer staples | 128,185 | 118,911 |
| Energy | 417,652 | 334,054 |
| Financials | 678,629 | 647,592 |
| Health care | 52,827 | 65,005 |
| Industrials | 237,971 | 276,782 |
| Information technology | 133,202 | 127,169 |
| Materials | 430,899 | 381,501 |
| Telecommunication services | 88,586 | 102,431 |
| Utilities | 6,970 | 31,345 |
| | 2,398,488 | 2,287,040 |
| Passive index | 7,228 | 3,839 |
| | 2,405,716 | 2,290,879 |
| **Private Equity Pool** | 11,007 | 13,627 |
| Receivable from sale of investments and accrued investment income | 15,872 | 15,850 |
| Liabilities for investment purchases | (2,332) | (3,710) |
| | 13,540 | 12,140 |
| | $ 2,464,637 | $ 2,350,542 |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $277,244,000 (2003 $235,967,000), which were used as underlying securities to support the notional amount of Canadian equity index swap contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

LOCAL AUTHORITIES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 30,359 | $ 44,347 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 179,336 | 234,270 |
| Consumer staples | 85,158 | 114,784 |
| Energy | 90,232 | 75,801 |
| Financials | 239,576 | 273,087 |
| Health care | 151,608 | 163,809 |
| Industrials | 167,265 | 155,722 |
| Information technology | 179,623 | 218,833 |
| Materials | 62,611 | 48,436 |
| Telecommunication services | 28,497 | 34,315 |
| Utilities | 37,167 | 35,736 |
| | 1,221,073 | 1,354,793 |
| Passive index | - | 764 |
| | 1,221,073 | 1,355,557 |
| Receivable from sale of investments and accrued investment income | 9,049 | 6,840 |
| Liabilities for investment purchases | (7,357) | (17,592) |
| | 1,692 | (10,752) |
| | $ 1,253,124 | $ 1,389,152 |

(a) The Plan's net investment in United States public equities includes the fair value of deposits and floating rate notes, totalling $475,532,000 (2003 $490,427,000) and absolute return strategy investments totalling $117,953,000 (2003 $nil), which were used as underlying securities to support the notional amount of US equity index swaps and futures contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

LOCAL AUTHORITIES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 34,181 | $ 32,381 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 258,357 | 267,333 |
| Consumer staples | 107,470 | 138,660 |
| Energy | 157,060 | 129,437 |
| Financials | 506,732 | 428,029 |
| Health care | 112,212 | 139,105 |
| Industrials | 202,971 | 190,706 |
| Information technology | 90,080 | 104,753 |
| Materials | 148,348 | 133,526 |
| Telecommunication services | 159,029 | 158,615 |
| Utilities | 73,966 | 68,141 |
| | 1,816,225 | 1,758,305 |
| Passive index | 47,258 | 252 |
| Receivable from sale of investments and accrued investment income | 23,612 | 18,627 |
| Liabilities for investment purchases | (7,749) | (6,921) |
| | 15,863 | 11,706 |
| | $ 1,913,527 | $ 1,802,644 |

(a) The Plan's net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $336,385,000 (2003 $331,992,000), which were used as underlying securities to support the notional amount of Non-North American equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. The following is a summary of the Plan's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased:

*(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| United Kingdom | $ 408,058 | $ 412,472 |
| Japan | 325,625 | 295,577 |
| France | 164,684 | 177,169 |
| Germany | 125,963 | 127,576 |
| Switzerland | 122,351 | 141,525 |
| Netherlands | 100,078 | 100,130 |
| Australia | 84,915 | 92,495 |
| Italy | 75,271 | 77,290 |
| Sweden | 47,139 | 34,359 |
| Spain | 46,576 | 48,281 |
| Other | 315,565 | 251,431 |
| | $ 1,816,225 | $ 1,758,305 |

LOCAL AUTHORITIES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 89 | $ 497 |
| **Real estate (a)** | | |
| Office | 422,704 | 271,419 |
| Retail | 303,552 | 256,942 |
| Industrial | 66,677 | 41,491 |
| Residential | 40,969 | 35,926 |
| | 833,902 | 605,778 |
| Passive index | 10,537 | 4,224 |
| Receivable from sale of investments and accrued investment income | 1,201 | 1,558 |
| | $ 845,729 | $ 612,057 |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

*(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| Ontario | $ 540,590 | $ 442,734 |
| Alberta | 184,873 | 150,624 |
| Quebec | 93,923 | - |
| British Columbia | 14,516 | 12,420 |
| | $ 833,902 | $ 605,778 |

# MANAGEMENT EMPLOYEES PENSION PLAN

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the Statement of Net Assets Available for Benefits and Accrued Benefits of the Management Employees Pension Plan (the Plan) as at December 31, 2004 and the Statements of Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits and Accrued Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
March 4, 2005

MANAGEMENT EMPLOYEES PENSION PLAN

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND ACCRUED BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net Assets Available For Benefits** | | |
| Assets | | |
| Investments (Note 3) | $ 1,721,340 | $ 1,566,939 |
| Accrued investment income and accounts receivable | 414 | 451 |
| Contributions receivable | | |
| Employees | 2,272 | 2,003 |
| Employers | 3,093 | 2,761 |
| | 1,727,119 | 1,572,154 |
| Liabilities | | |
| Accounts payable | 141 | 240 |
| **Net assets available for benefits** | 1,726,978 | 1,571,914 |
| **Accrued Benefits** | | |
| Actuarial value of accrued benefits | 1,995,079 | 1,861,928 |
| **Deficiency** | $ (268,101) | $ (290,014) |

*See accompanying notes and schedules.*

MANAGEMENT EMPLOYEES PENSION PLAN

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the year ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net investment income (Note 6)** | | |
| Investment income | $ 163,041 | $ 190,938 |
| Investment expenses | (2,765) | (1,930) |
| | 160,276 | 189,008 |
| **Member service operations** | | |
| Contributions | | |
| Current and optional service | | |
| Employees | 28,648 | 23,782 |
| Employers | 38,015 | 32,515 |
| Pension benefits | (68,145) | (61,296) |
| Refunds to members | (2,117) | (1,143) |
| Transfers to other plans, net | (186) | (170) |
| Member service expenses (Note 7) | (1,427) | (1,363) |
| | (5,212) | (7,675) |
| **Increase in net assets** | 155,064 | 181,333 |
| **Net assets available for benefits at beginning of year** | 1,571,914 | 1,390,581 |
| **Net assets available for benefits at end of year** | $ 1,726,978 | $ 1,571,914 |

*See accompanying notes and schedules.*

MANAGEMENT EMPLOYEES PENSION PLAN

## STATEMENT OF CHANGES IN ACCRUED BENEFITS

For the year ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in accrued benefits** | | |
| Interest accrued on benefits | $ 126,393 | $ 114,351 |
| Benefits earned | 62,828 | 56,524 |
| | 189,221 | 170,875 |
| **Decrease in accrued benefits** | | |
| Benefits paid and transfers | (70,448) | (62,608) |
| **Other changes in accrued benefits** (Note 8) | | |
| Net experience losses (gains) | 14,378 | (14,493) |
| Changes in actuarial assumptions | - | 60,165 |
| Change in the maximum pensionable salary limit | - | 15,440 |
| | 14,378 | 61,112 |
| **Net increase in accrued benefits** | 133,151 | 169,379 |
| **Accrued benefits at beginning of year** | 1,861,928 | 1,692,549 |
| **Accrued benefits at end of year (Note 8)** | $ 1,995,079 | $ 1,861,928 |

*See accompanying notes and schedules.*

## STATEMENT OF CHANGES IN DEFICIENCY

For the year ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Deficiency at beginning of year** | $ (290,014) | $ (301,968) |
| Increase in net assets available for benefits | 155,064 | 181,333 |
| Net increase in accrued benefits | (133,151) | (169,379) |
| **Deficiency at end of year** | $ (268,101) | $ (290,014) |

*See accompanying notes and schedules.*

MANAGEMENT EMPLOYEES PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Management Employees Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000 and Alberta Regulation 367/93, as amended.

**(a) General**

The Plan is a contributory defined benefit pension plan for eligible management employees of the Province of Alberta and certain approved provincial agencies and public bodies. Members of the former Public Service Management Pension Plan who were active contributors at August 1, 1992 and have not withdrawn from the Plan since that date continue as members of this Plan. The Plan is a registered pension plan as defined in the *Income Tax Act*. The Plan's registration number is 0570887.

**(b) Funding Policy**

Current service costs and the Plan's actuarial deficiency (see Note 9) are funded by employee and employer contributions at rates which together with investment earnings are expected to provide for all benefits payable under the Plan. The rates in effect at December 31, 2004 were unchanged at 9.5% of pensionable salary for employees and 13.1% for employers. The rates are reviewed at least once every three years by the Minister of Finance, in consultation with the Board, based on recommendations of the Plan's actuary.

**(c) Retirement Benefits**

The Plan provides a pension of 2.0% for each year of pensionable service based on the average salary of the highest five consecutive years. Pensionable earnings after December 31, 1991 are capped at the yearly maximum pensionable earnings limit as defined by the federal *Income Tax Act*. The maximum service allowable under the Plan is 35 years.

Pensions are payable to members who have attained age 65 at retirement.

Members are entitled to an unreduced pension on service before 1992 if they have attained age 55 and have at least five years of service.

Members are entitled to an unreduced pension on service after 1991 if they retire with at least five years of service and have either attained age 60, or age 55 and the sum of their age and years of service equals 80. Pensions on service after 1991 are reduced if the member is under age 60 and the 80 factor is not attained.

**(d) Disability Benefits**

Pensions are payable to members who become totally disabled and retire early with at least five years of service. Reduced pensions are payable to members who become partially disabled and retire early with at least five years of service.

MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 1 (continued)**

**(e) Death Benefits**

Death benefits are payable on the death of a member. If the member has at least five years of service, a surviving pension partner may choose to receive a survivor pension, or a lump sum payment. For a beneficiary other than a pension partner, or where service is less than five years, the benefits take the form of a lump sum payment.

**(f) Termination Benefits**

Members who terminate with fewer than five years of service receive a refund of their contributions plus interest.

Members who terminate with more than five years of service and are not immediately entitled to a pension may apply for a lump sum payment or a deferred pension. The lump sum payment is based on contributions and interest in relation to service before 1992 and commuted value for service after 1991. The commuted value portion of the lump sum payment is subject to the Plan's lock-in provisions.

**(g) Optional Service and Transfers**

All optional service purchases are to be cost-neutral to the Plan.

Reciprocal agreements provide that transferred-in service be on an actuarial reserve basis and transfers out receive the greater of the termination benefits or commuted value for all service.

**(h) Cost-of-Living Adjustments**

Pensions payable are increased on January 1st of each year by an amount equal to at least 60% of the average of the increases in the Alberta Consumer Price Index in the twelve-month period ending on October 31st of the previous year.

**(i) Guarantee**

The Province of Alberta guarantees payment of all benefits arising from service before 1994.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist plan members and others in reviewing the activities of the Plan for the year.

Except for real rate of return bonds which are held directly by the Plan, Plan investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 2 (continued)**

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Plan or by pooled investment funds are explained in the following paragraphs:

(i) Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

(ii) Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

(iii) The fair value of alternative investments including investments in private investment funds, private equities and securities with limited marketability is estimated by Alberta Finance or external managers appointed by Alberta Finance using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

(iv) Real estate investments are reported at their most recent appraised value net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

(v) The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange except for hedged foreign currency transactions, which are translated at rates of exchange established by the terms of the forward exchange contracts. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 2 (continued)**

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

(ii) Interest rate swaps are valued based on discounted cash flows using current market yields.

(iii) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

(iv) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

(v) Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's actuarial value of accrued benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Plan's actuarial value of accrued benefits, management considers that it is possible, based on existing knowledge, that changes in future conditions in the short term could require a material change in the recognized amounts. Differences between actual results and expectations are disclosed as assumption or other changes and net experience gains or losses in the statement of changes in accrued benefits.

MANAGEMENT EMPLOYEES PENSION PLAN

## NOTE 3 INVESTMENTS (SCHEDULES A TO E)
*(thousands)*

| | 2004 Fair Value | % | 2003 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 29,865 | 1.7 | $ 17,784 | 1.1 |
| Canadian Dollar Public Bond Pool (b) | 476,729 | 27.7 | 416,281 | 26.6 |
| Real rate of return bonds (c) | 82,288 | 4.8 | 76,810 | 4.9 |
| Private Mortgage Pool (d) | 81,601 | 4.7 | 74,164 | 4.7 |
| Total fixed income securities | 670,483 | 38.9 | 585,039 | 37.3 |
| **Canadian Equities (Schedule B)** | | | | |
| External Managers | | | | |
| Canadian Large Cap Equity Pool (e) | 187,979 | 10.9 | 176,303 | 11.2 |
| Canadian Small Cap Equity Pool (e) | 56,075 | 3.3 | 47,117 | 3.0 |
| Domestic Passive Equity Pooled Fund (f) | 121,534 | 7.1 | 123,569 | 7.9 |
| Growing Equity Income Pool (g) | 34,188 | 2.0 | - | - |
| Canadian Pooled Equities Fund (h) | 34,941 | 2.0 | 71,618 | 4.6 |
| Private Equity Pool (i) | 1,565 | 0.1 | 1,928 | 0.1 |
| | 436,282 | 25.4 | 420,535 | 26.8 |
| **United States Equities (Schedule C)** | | | | |
| External Managers | | | | |
| US Large Cap Equity Pool (j) | 101,166 | 5.9 | 99,316 | 6.3 |
| US Mid/Small Cap Equity Pool (j) | 29,414 | 1.7 | 29,816 | 1.9 |
| S&P 500 Pooled Index Fund (k) | 66,006 | 3.8 | 53,493 | 3.4 |
| US Passive Equity Pooled Fund (k) | 49,246 | 2.9 | 47,599 | 3.1 |
| Growing Equity Income Pool (g) | 3,397 | 0.2 | - | - |
| | 249,229 | 14.5 | 230,224 | 14.7 |
| **Non-North American Equities (Schedule D)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (l) | 134,631 | 7.8 | 132,448 | 8.5 |
| EAFE Plus Equity Pool (l) | 67,382 | 3.9 | 59,305 | 3.8 |
| Emerging Markets Equity Pool (m) | 18,329 | 1.1 | - | - |
| EAFE Passive Equity Pool (n) | 13,414 | 0.8 | 31,954 | 2.0 |
| EAFE Structured Equity Pooled Fund (n) | 35,436 | 2.1 | 31,544 | 2.0 |
| | 269,192 | 15.7 | 255,251 | 16.3 |
| **Alternative Investments - Equities** | | | | |
| Private Equity 2002 , Private Equity 2004 and Private Income Pools (o) | 12,963 | 0.7 | 2,978 | 0.2 |
| **Real Estate Equities (Schedule E)** | | | | |
| Private Real Estate Pool (p) | 83,191 | 4.8 | 72,912 | 4.7 |
| Total equities | 1,050,857 | 61.1 | 981,900 | 62.7 |
| **Total investments** | $ 1,721,340 | 100.0 | $ 1,566,939 | 100.0 |

# MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 3 (continued)**

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) Real rate of return bonds are issued or guaranteed by the Government of Canada and bear interest at a fixed rate adjusted for inflation.

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. To limit investment risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(e) The External Managers Canadian Large Cap and Small Cap Equity Pools consist of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap or small cap equity markets. The Small Cap Pool is restricted to investing in publicly traded Canadian equities with a market capitalization of up to 0.15% of the Toronto Stock Exchange S&P/TSX Composite Index total market capitalization at time of purchase. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

(f) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(g) The Growing Equity Income Pool is managed with the objective of providing returns higher than the return of S&P/TSX Custom Dividend Index over a four-year period. The Pool is intended to provide a steady stream of dividend income with potential for capital appreciation by investing in dividend-paying Canadian and US companies that exhibit attractive valuation, growth and quality financial characteristics.

(h) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection and sector rotation.

(i) The Private Equity Pool is in the process of orderly liquidation.

(j) The External Managers US Large Cap Equity Pool consists of multiple portfolios and the External Managers US Mid/Small Cap Equity Pool consists of a single portfolio of publicly traded United States equities. Each portfolio is actively managed by an external manager with expertise in the US large cap or mid/small cap equity markets. The performance objective is to provide returns higher than the total return of the Standard & Poor's S&P 500 Index for the US Large Cap Pool and the Russell 2500 Index for the US Mid/Small Cap Pool over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 3 (continued)**

(k) The S&P 500 Pooled Index Fund and the US Passive Equity Pooled Fund are passively managed. The portfolios are comprised of publicly traded United States equities similar in weights to the S&P 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. The pools utilize a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pools also invest in futures, swaps and other structured investments.

(l) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each Core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

(m) The External Managers Emerging Markets Equity Pool consists of a single portfolio of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index (MSCI) Emerging Markets Free (EMF) Index over a four-year period.

(n) The External Managers EAFE Passive Equity Pool and the EAFE Structured Equity Pooled Fund's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The External Managers EAFE Passive Equity Pool consists of a single portfolio of Non-North American publicly traded equities similar in weights to the MSCI EAFE index. The EAFE Structured Equity Pooled Fund is internally managed and provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

(o) The Private Equity Pool 2002 and Private Equity Pool 2004 are managed with the objective of providing investment returns comparable to the S&P/TSX Composite Index plus 2.5% over the long term. The pools invest in institutionally sponsored Canadian private equity pools managed by experienced advisors with proven records. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool is managed with the objective of providing an investment return comparable to the Consumer Price Index plus 6% over the long term. The pool invests in infrastructure related projects that are structured to provide high current income.

(p) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediate companies, which have issued to the pool common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

MANAGEMENT EMPLOYEES PENSION PLAN

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Plan are primarily affected by the long term real rate of return expected to be earned on investments. The expected rate of return on investments, together with the expected long term inflation rate, form the basis for determining the economic assumptions used in calculating the actuarial liabilities.

In order to earn the best possible return at an acceptable level of risk, the Board has established a benchmark policy asset mix of 40% fixed income instruments and 60% equities. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

MANAGEMENT EMPLOYEES PENSION PLAN

**NOTE 5 (continued)**

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Plan's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at December 31, 2004:

*(thousands)*

| | Maturity | | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Net Fair Value (a) | Notional Amount | Net Fair Value (a) |
| | | % | | | | | |
| Equity index swap contracts | 79 | 21 | - | $ 185,918 | $ 6,919 | $ 173,631 | $ 6,901 |
| Interest rate swap contracts | 41 | 52 | 7 | 84,082 | (3,116) | 91,375 | (4,039) |
| Cross-currency interest rate swap contracts | 17 | 26 | 57 | 83,528 | (3,237) | 59,519 | (5,038) |
| Forward foreign exchange contracts | 100 | - | - | 32,993 | 334 | 6,070 | 42 |
| Credit default swap contracts | 21 | 23 | 56 | 20,995 | 120 | 3,812 | (47) |
| Bond index swap contracts | 100 | - | - | 9,294 | 180 | 6,704 | 10 |
| Equity index futures contracts | 100 | - | - | 4,916 | 415 | 1,895 | 205 |
| | | | | $ 421,726 | $ 1,615 | $ 343,006 | $ (1,966) |

(a) The method of determining fair value of derivative contracts is described in Note 2 (e).

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

MANAGEMENT EMPLOYEES PENSION PLAN

## NOTE 6 NET INVESTMENT INCOME

Net investment income of the Plan is comprised of the following:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Investment income | | |
| Net realized and unrealized gains on investments, including those arising from derivative transactions | $ 101,697 | $ 135,925 |
| Interest income | 41,734 | 36,992 |
| Dividend income | 15,035 | 13,664 |
| Real estate income | 4,182 | 3,958 |
| Securities lending income | 393 | 399 |
| | 163,041 | 190,938 |
| Investment expenses | (2,765) | (1,930) |
| **Net investment income** | $ 160,276 | $ 189,008 |

The following is a summary of the Plan's proportionate share of net investment income (loss) by type of investments:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Fixed Income Securities | $ 55,322 | $ 44,055 |
| Canadian Equities | 59,951 | 88,091 |
| Foreign Equities | | |
| United States | 7,663 | 15,924 |
| Non-North American | 29,890 | 34,008 |
| Alternative Investments - Equities | (366) | 121 |
| Real Estate Equities | 7,816 | 6,809 |
| | $ 160,276 | $ 189,008 |

Investment expenses totalling $2,765,000 (2003 $1,930,000) are included in the calculation of Plan's investment performance results, which are as follows:

| | One-Year Return | Four-Year Compound Annualized Return | Eight-Year Compound Annualized Return |
|---|---|---|---|
| **Time-weighted rates of return*** | | | |
| Overall Plan | 10.2% | 3.2% | 7.2% |
| Policy Benchmark** | 9.8% | 2.9% | 7.0% |

* The measure involves the calculation of the net return realized by the Plan over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains and losses (realized and unrealized).

** The policy benchmark return is a product of the weighted average policy sector weights and sector returns.

MANAGEMENT EMPLOYEES PENSION PLAN

## NOTE 7 MEMBER SERVICE EXPENSES

Member service expenses including Board costs in the amount of $49,000 (2003 $48,000) were charged to the Plan on a cost-recovery basis.

## NOTE 8 ACCRUED BENEFITS

### (a) Actuarial Valuation

An interim actuarial valuation of the Plan was carried out as at December 31, 2003 by Aon Consulting Inc. and was extrapolated to December 31, 2004. The 2003 valuation was completed after the financial statements of the Plan for 2003 were released. As a result, the differences between the actuarial valuation and extrapolation results for 2003 are accounted for as net experience losses in 2004.

Actuarial valuations were determined using the projected benefit method prorated on service. The assumptions used in the valuations and extrapolations were developed as the best estimates of expected short term and long term market conditions and other future events. After consultation with the Plan's actuary, the Board approved these best estimates.

The major assumptions used were:

| | **2003 Valuation and 2004 Extrapolation %** | **2002 Valuation and 2003 Extrapolation %** |
|---|---|---|
| Asset real rate of return | 4.00 | 4.00 |
| Inflation rate | 2.75 | 2.75 |
| Investment rate of return | 6.75 | 6.75 |
| Salary escalation rate* | 3.25 | 3.25 |

* In addition to merit and promotion.

An actuarial funding valuation of the Plan as at December 31, 2004 will be carried out subsequent to the completion of these financial statements as required by the *Public Sector Pension Plans Act*. Any differences between the actuarial valuation results and the extrapolation results as reported in these financial statements, including the impact of changes to the maximum pensionable salary limit as announced in the 2005 Federal Budget estimated to amount to $6.4 million, will affect the financial position of the Plan and will be accounted for as gains or losses in 2005.

**NOTE 8 (continued)**

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation and extrapolation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's deficiency and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2004:

| | | Sensitivities | |
|---|---|---|---|
| | **Changes in Assumptions %** | **Increase in Plan Deficiency ($ millions)** | **Increase in Current Service Cost as a % of Pensionable Earnings *** |
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 143 | 1.1% |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 30 | 0.5% |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant | (1.0%) | 284 | 3.7% |

* The current service cost as a % of pensionable earnings as determined by the December 31, 2003 valuation was 21.7%

## NOTE 9 FUNDING VALUATION AND EXTRAPOLATION

The Plan's deficiency is determined on the fair value basis for accounting purposes. For funding valuation and extrapolation purposes, asset values are adjusted for fluctuations in fair values to moderate the effect of market volatility on the Plan's funded status. Actuarial asset values for funding valuation and extrapolation purposes amounted to $1,731.5 million at December 31, 2004 (2003 $1,650.5 million).

**NOTE 9 (continued)**

In accordance with the *Public Sector Pension Plans Act*, the actuarial deficiency of $49.2 million as determined by an actuarial funding valuation as at December 31, 2001 is funded by a special payment of 2.1% of pensionable earnings shared between employees and employers commencing on April 1, 2003 and continuing for 15 years from the date of valuation to December 31, 2016. The special payment is included in the rates in effect at December 31, 2004 (see Note 1(b)).

An interim actuarial valuation as at December 31, 2003 indicated an increase in annual funding of approximately $21 million (2003 $21 million) commencing in 2005 and continuing until 2018. The next actuarial funding valuation is required no later than December 31, 2004 (see Note 1(b) and Note 8(a)). The Board will continue to monitor the Plan's financial position on an annual basis.

## NOTE 10 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2004 presentation.

## NOTE 11 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were prepared by management and approved by the Management Employees Pension Board.

MANAGEMENT EMPLOYEES PENSION PLAN

# SCHEDULES TO THE MANAGEMENT EMPLOYEES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

For the Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 32,805 | $ 20,065 |
| **Fixed income securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 215,109 | 182,515 |
| Provincial | | |
| Alberta, direct and guaranteed | 301 | 318 |
| Other, direct and guaranteed | 115,284 | 66,990 |
| Municipal | 6,249 | 6,383 |
| Corporate | 177,847 | 193,278 |
| Private | | |
| Corporate | 120,959 | 115,177 |
| | 635,749 | 564,661 |
| Receivable from sale of investments and accrued investment income | 5,819 | 5,410 |
| Liabilities for investment purchases | (3,890) | (5,097) |
| | 1,929 | 313 |
| | $ 670,483 | $ 585,039 |

(a) Fixed income securities held as at December 31, 2004 had an average effective market yield of 4.13% per annum (2003 4.52% per annum). The following term structure of these securities as at December 31, 2004 was based on principal amount:

| | 2004 % | 2003 % |
|---|---|---|
| under 1 year | 2 | 3 |
| 1 to 5 years | 32 | 33 |
| 6 to 10 years | 29 | 27 |
| 11 to 20 years | 15 | 11 |
| over 20 years | 22 | 26 |
| | 100 | 100 |

MANAGEMENT EMPLOYEES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

For the Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 4,355 | $ 4,328 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 35,330 | 34,514 |
| Consumer staples | 21,496 | 20,262 |
| Energy | 77,428 | 59,460 |
| Financials | 128,383 | 118,917 |
| Health care | 8,089 | 10,564 |
| Industrials | 38,391 | 44,418 |
| Information technology | 23,041 | 23,839 |
| Materials | 72,870 | 68,922 |
| Telecommunication services | 17,905 | 19,096 |
| Utilities | 2,734 | 9,484 |
| | 425,667 | 409,476 |
| Passive index | 897 | 745 |
| | 426,564 | 410,221 |
| **Private Equity Pool** | 1,565 | 1,928 |
| Receivable from sale of investments and accrued investment income | 4,124 | 4,845 |
| Liabilities for investment purchases | (326) | (787) |
| | 3,798 | 4,058 |
| | $ 436,282 | $ 420,535 |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $88,081,000 (2003 $80,751,000), which were used as underlying securities to support Canadian equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

MANAGEMENT EMPLOYEES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

For the Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 4,367 | $ 4,570 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 39,251 | 37,621 |
| Consumer staples | 19,689 | 20,513 |
| Energy | 16,612 | 12,947 |
| Financials | 50,150 | 45,279 |
| Health care | 29,806 | 27,459 |
| Industrials | 32,691 | 25,922 |
| Information technology | 33,596 | 36,538 |
| Materials | 9,331 | 8,083 |
| Telecommunication services | 6,087 | 6,010 |
| Utilities | 6,941 | 5,675 |
| | 244,154 | 226,047 |
| Passive index | - | 81 |
| | 244,154 | 226,128 |
| Receivable from sale of investments and accrued investment income | 1,542 | 1,198 |
| Liabilities for investment purchases | (834) | (1,672) |
| | 708 | (474) |
| | $ 249,229 | $ 230,224 |

(a) The Plan's net investment in United States public equities includes the fair value of deposits and floating rate notes, totalling $69,299,000 (2003 $60,812,000), which were used as underlying securities to support US equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's S&P 500 Index.

MANAGEMENT EMPLOYEES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

For the Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 4,928 | $ 4,459 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 36,333 | 37,769 |
| Consumer staples | 14,966 | 19,582 |
| Energy | 21,981 | 18,522 |
| Financials | 71,394 | 61,186 |
| Health care | 15,614 | 19,885 |
| Industrials | 28,625 | 27,101 |
| Information technology | 12,660 | 14,901 |
| Materials | 20,990 | 18,730 |
| Telecommunications services | 22,184 | 22,282 |
| Utilities | 10,356 | 9,788 |
| | 255,103 | 249,746 |
| Passive index | 7,706 | 33 |
| Receivable from sale of investments and accrued investment income | 2,557 | 1,971 |
| Liabilities for investment purchases | (1,102) | (958) |
| | 1,455 | 1,013 |
| | $ 269,192 | $ 255,251 |

(a) The Plan's net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $33,454,000 (2003 $30,297,000), which were used as underlying securities to support the notional amount of Non-North American equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. The following is a summary of the Plan's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased.

*(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| United Kingdom | $ 57,539 | $ 58,892 |
| Japan | 45,877 | 42,905 |
| France | 22,920 | 24,951 |
| Germany | 17,576 | 18,155 |
| Switzerland | 17,170 | 20,024 |
| Netherlands | 13,908 | 14,201 |
| Australia | 11,767 | 13,055 |
| Italy | 10,549 | 10,860 |
| Spain | 6,494 | 6,988 |
| Sweden | 6,485 | 4,887 |
| Other | 44,818 | 34,828 |
| | $ 255,103 | $ 249,746 |

MANAGEMENT EMPLOYEES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

For the Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 9 | $ 59 |
| **Real estate (a)** | | |
| Office | 41,579 | 32,332 |
| Retail | 29,859 | 30,609 |
| Industrial | 6,559 | 4,943 |
| Residential | 4,030 | 4,280 |
| | 82,027 | 72,164 |
| Passive index | 1,037 | 503 |
| Receivable from sale of investments and accrued investment income | 118 | 186 |
| | $ 83,191 | $ 72,912 |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

*(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| Ontario | $ 53,175 | $ 52,741 |
| Alberta | 18,185 | 17,943 |
| Quebec | 9,239 | - |
| British Columbia | 1,428 | 1,480 |
| | $ 82,027 | $ 72,164 |

# PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## Financial Statements

YEAR ENDED MARCH 31, 2005

AUDITOR GENERAL
*Alberta*

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the Statement of Net Assets Available for Benefits and Accrued Benefits of the Provincial Judges and Masters in Chambers (Registered) Pension Plan (the Plan) as at March 31, 2005 and the Statement of Changes in Net Assets Available for Benefits for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits and Accrued Benefits of the Plan as at March 31, 2005 and the Changes in Net Assets Available for Benefits for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
June 17, 2005

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND ACCRUED BENEFITS

As at March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Investments (Note 3) | $ 82,878 | $ 77,926 |
| Contributions receivable | 175 | 169 |
| Accounts receivable | 2 | - |
| | 83,055 | 78,095 |
| Liabilities | | |
| Accounts payable | 14 | 14 |
| Net assets available for benefits | 83,041 | 78,081 |
| **Accrued Benefits** | | |
| Accrued benefits (Note 7) | 83,625 | 79,453 |
| **Actuarial Deficiency (Note 8)** | $ (584) | $ (1,372) |

*See accompanying notes and schedules.*

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended March 31, 2005 *(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Increase in assets** | | |
| Net investment income (Note 9) | $ 5,680 | $ 14,014 |
| Contributions | | |
| Current and optional service | | |
| Provincial Judges and Masters in Chambers | 687 | 655 |
| Province of Alberta | 1,385 | 1,280 |
| Unfunded liabilities (Note 8) | | |
| Province of Alberta | 1,172 | 1,172 |
| | 3,244 | 3,107 |
| | 8,924 | 17,121 |
| **Decrease in assets** | | |
| Pension benefits | 3,871 | 3,590 |
| Administration expenses (Note 10) | 93 | 86 |
| | 3,964 | 3,676 |
| **Increase in net assets** | 4,960 | 13,445 |
| **Net assets available for benefits at beginning of year** | 78,081 | 64,636 |
| **Net assets available for benefits at end of year** | $ 83,041 | $ 78,081 |

*See accompanying notes and schedules.*

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Provincial Judges and Masters in Chambers (Registered) Pension Plan (Registered Plan) is a summary only. For a complete description of the Registered Plan, reference should be made to the *Provincial Court Act*, Chapter P-31, Revised Statutes of Alberta 2000, *Court of Queen's Bench Act*, Chapter C-31, Revised Statutes of Alberta 2000, *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 and Alberta Regulation 196/2001.

**(a) General**

Effective April 1, 1998, the Registered Plan is a contributory defined benefit pension plan for Provincial Judges and Masters in Chambers of the Province of Alberta. The Registered Plan is a registered pension plan as defined in the *Income Tax Act* and is not subject to income taxes. The Registered Plan's registration number is 0927764.

**(b) Funding Policy**

Current service costs are funded by the Province of Alberta and plan members at rates which are expected to provide for all benefits payable under the Registered Plan. The rates in effect at March 31, 2005 remained unchanged at 7.0% of *capped salary* for plan members and 14.03% of *capped salary* for the Province. The rates are to be reviewed at least once every three years by the Province based on recommendations of the Registered Plan's actuary.

**(c) Retirement Benefits**

The Registered Plan provides for a pension of 2.0% for each year of pensionable service based on the average salary of the highest five consecutive years. Pensionable earnings after December 31, 1991 are capped at the *maximum benefit accrual limit* as set out in the federal *Income Tax Act.* The maximum benefit accrual percentage allowable under the Registered Plan is 70%. The normal pensionable age is 70 years of age.

Members are entitled to an unreduced pension on service before 1992 if they have attained age 55 and have at least five years of service.

Members are entitled to an unreduced pension on service after 1991 and before April 1, 1998 if they retire with at least five years of service and have either attained age 60 or age 55 and the sum of their age and service equals 80. Pensions are reduced if the member is under age 60 and the 80 factor is not attained at age 55.

Members are entitled to an unreduced pension on service after March 31, 1998 if they retire with at least five years of service and have attained age 60 and the sum of their age and service equals 80. Pensions are reduced if the member is under age 60 or if the 80 factor is not attained at age 60. The 80-factor requirement does not apply to members who have attained age 70.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 1 (continued)**

**(d) Disability Benefits**

Pensions are payable to members who become totally disabled and retire early with at least five years of service. Reduced pensions are payable to members who become partially disabled and retire early with at least five years of service.

**(e) Death Benefits**

Death benefits are payable on the death of a member. If the member has at least five years of service, a surviving pension partner may choose to receive a survivor pension. For a beneficiary other than a pension partner or where service is less than five years, a lump sum payment must be chosen.

**(f) Termination Benefits**

Members who terminate with fewer than five years of service receive a refund of their own contributions plus interest.

Members who terminate with more than five years of service and are not immediately entitled to a pension may apply for a deferred pension.

**(g) Province's Liability for Benefits**

Benefits are payable by the Province of Alberta if assets are insufficient to pay for all benefits under the Registered Plan.

**(h) Cost-of-Living Adjustments**

Pensions payable are increased on January 1st of each year by an amount equal to at least 60% of the average of the increases in the Alberta Consumer Price Index in the twelve-month period ending on October 31st of the previous year.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Registered Plan to meet future benefit payments and are prepared to assist plan members and others in reviewing the activities of the Registered Plan for the year.

Plan investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

**NOTE 2 (continued)**

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Registered Plan or by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

The fair value of private equities is estimated by Alberta Finance using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate.

Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. At the year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of investment income or loss.

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 2 (continued)**

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in investment income or losses. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's accrued benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Plan's accrued benefits, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are disclosed as assumption changes and net experience gains or losses in the statement showing the changes in the value of accrued benefits (see Note 7).

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## NOTE 3 INVESTMENTS (SCHEDULES B TO F)

*(thousands)*

| | 2005 Fair Value | % | 2004 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule B)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 993 | 1.2 | $ 1,345 | 1.7 |
| Canadian Dollar Public Bond Pool (b) | 29,255 | 35.3 | 28,160 | 36.1 |
| Private Mortgage Pool (c ) | 4,938 | 6.0 | 4,731 | 6.1 |
| Total fixed income securities | 35,186 | 42.5 | 34,236 | 43.9 |
| **Canadian Equities (Schedule C)** | | | | |
| Domestic Passive Equity Pooled Fund (d) | 7,239 | 8.7 | 6,995 | 9.0 |
| Canadian Pooled Equities Fund (e) | 4,485 | 5.4 | 3,871 | 5.0 |
| External Managers | | | | |
| Canadian Equity Enhanced Index Pool (f) | 2,237 | 2.7 | - | - |
| Canadian Large Cap Equity Pool (g) | 1,451 | 1.8 | 4,141 | 5.3 |
| Canadian Small Cap Equity Pool | - | - | 499 | 0.6 |
| Growing Equity Income Pool (h) | 1,069 | 1.3 | - | - |
| Canadian Multi-Cap Pool (i) | 947 | 1.1 | - | - |
| Private Equity Pool (j) | 115 | 0.2 | 128 | 0.2 |
| Overlay US Equity Pool (n) | (843) | -1.0 | - | - |
| | 16,700 | 20.2 | 15,634 | 20.1 |
| **United States Equities (Schedule D)** | | | | |
| S&P 500 Pooled Index Fund (k) | 6,059 | 7.3 | 2,810 | 3.6 |
| US Passive Equity Pooled Fund (k) | 2,913 | 3.5 | 2,952 | 3.8 |
| Portable Alpha US Pool (l) | 1,475 | 1.8 | - | - |
| External Managers | | | | |
| US Mid/Small Cap Equity Pool (m) | 1,472 | 1.8 | 767 | 1.0 |
| US Large Cap Equity Pool | - | - | 4,747 | 6.1 |
| Overlay US Equity Pool (n) | 1,013 | 1.2 | - | - |
| Growing Equity Income Pool (h) | 170 | 0.2 | - | - |
| | 13,102 | 15.8 | 11,276 | 14.5 |
| **Non-North American Equities (Schedule E)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (o) | 6,618 | 8.0 | 6,398 | 8.2 |
| EAFE Plus Equity Pool (o) | 3,160 | 3.8 | 2,964 | 3.8 |
| Emerging Markets Equity Pool (p) | 905 | 1.1 | - | - |
| EAFE Passive Equity Pool (q) | 791 | 0.9 | 1,520 | 1.9 |
| EAFE Structured Equity Pooled Fund (q) | 1,631 | 2.0 | 1,525 | 2.0 |
| | 13,105 | 15.8 | 12,407 | 15.9 |
| **Real Estate Equities (Schedule F)** | | | | |
| Private Real Estate Pool (r) | 4,785 | 5.7 | 4,373 | 5.6 |
| Total equities | 47,692 | 57.5 | 43,690 | 56.1 |
| **Total investments** | $ 82,878 | 100.0 | $ 77,926 | 100.0 |

(a) The Consolidated Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 3 (continued)**

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. In order to reduce risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(d) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(e) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection while remaining sector neutral.

(f) The External Managers Canadian Equity Enhanced Index Pool consists of a single portfolio of publicly traded Canadian equities in the large cap market and is designed to generate a consistent level of investment return above the total return of the S&P/TSX Composite Index over a four-year period with relatively low risk.

(g) The External Managers Canadian Large Cap Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity markets. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple managers each of whom has a different investment style and market capitalization focus.

(h) The Growing Equity Income Pool is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index over a four-year period while maintaining a steady and growing stream of dividend income to participants. The portfolio is comprised of publicly traded equities in mature Canadian corporations with strong financial characteristics and dividend growth history and is designed to reduce risk by holding securities of established and well-capitalized companies.

(i) The Canadian Multi-Cap Pool consists of a single portfolio with multiple components. The large cap component is internally managed and provides exposure to the Canadian equity market through structured investments replicating the S&P/TSX 60 Index. The small/mid cap component is comprised of investments in the External Managers Canadian Multi-Cap Pool. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period.

(j) The Private Equity Pool is in the process of orderly liquidation.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 3 (continued)**

(k) The S&P 500 Pooled Index Fund and the US Passive Equity Pooled Fund are passively managed. The portfolios are comprised of publicly traded United States equities similar in weights to the S&P 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. The pools utilize a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pools also invests in futures, swaps and other structured investments.

(l) The Portable Alpha US Pool provides exposure to the United States equity market by replicating the S&P 500 Index with S&P 500 index swaps and futures contracts. Externally managed absolute return strategy investments and money market instruments are actively used as underlying securities to add value to the exposure. The performance objective is to provide returns higher than the S&P 500 Index over the long term.

(m) The External Managers US Mid/Small Cap Equity Pool consists of a single portfolio of publicly traded United States equities actively managed by an external manager with expertise in the US mid/small cap equity markets. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period while reducing return volatility.

(n) The Overlay US Equity Pool is managed with the objective of providing a quick, effective and efficient way to reduce exposure to Canadian equities and increase exposure to United States equities through synthetic instruments on a largely unfunded basis. The Pool is comprised of a long position through United States equity index futures contracts and a short position through Canadian equity index futures contract. Cash and short-term securities held by the Pool support approximately 5% to 10% of the Pool's notional exposure in Canadian and United States equity index futures contracts.

(o) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with fewer constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

(p) The External Managers Emerging Markets Equity Pool consists of a single portfolio of publicly traded equities in emerging markets around the world. The portfolio is actively managed by an external manager with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International Emerging Markets Free (MSCI EMF) Index over a four-year period.

(q) The External Managers EAFE Passive Equity Pool and the EAFE Structured Equity Pooled Fund's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The External Managers EAFE Passive Equity Pool consists of a single portfolio of Non-North American publicly traded equities similar in weights to the MSCI EAFE index. The EAFE Structured Equity Pooled Fund is internally managed and provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

(r) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediate companies, which have issued to the pool common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Registered Plan are primarily affected by the long-term real rate of return on investments. In order to earn the best possible return at an acceptable level of risk, management has established a policy asset mix of 45% fixed income instruments and 55% equities. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Registered Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest, credit and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 5 (continued)**

The following is a summary of the Registered Plan's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005:

*(thousands)*

| | Maturity | | | 2005 | | 2004 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Net Fair Value (a) | Notional Amount | Net Fair Value (a) |
| | | % | | | | | |
| Equity index swap contracts | 66 | 34 | - | $13,747 | $ (1) | $10,400 | $ (69) |
| Interest rate swap contracts | 39 | 49 | 12 | 4,645 | (122) | 5,591 | (279) |
| Cross-currency interest rate swap contracts | 14 | 30 | 56 | 5,710 | (48) | 4,447 | (578) |
| Forward foreign exchange contracts | 100 | - | - | 1,900 | 12 | 539 | (2) |
| Credit default swap contracts | 29 | 10 | 61 | 1,343 | 8 | 483 | (3) |
| Bond index swap contracts | 100 | - | - | 569 | 4 | 398 | 10 |
| Equity index futures contracts | 100 | - | - | 2,010 | 24 | 108 | 14 |
| | | | | $29,924 | $ (123) | $21,966 | $ (907) |

(a) The method of determining fair value of derivative contracts is described in Note 2 (e).

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

## NOTE 6 PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (UNREGISTERED) PENSION PLAN (UNREGISTERED PLAN)

The Unregistered Plan is established with effect from April 1, 1998 to collect contributions and to provide pension benefits to plan members in excess of the maximum benefits allowed by the *Income Tax Act*. The Unregistered Plan is a *Retirement Compensation Arrangement* (RCA) under the *Income Tax Act* and is administered by the Province separately. Accordingly, the Unregistered Plan's assets, liabilities and net assets available for benefits referred to below have not been included in these financial statements.

The Unregistered Plan is funded by contributions from plan members and the Province. The contribution rates in effect at March 31, 2005 were unchanged at 7.0% of pensionable salary in excess of *capped salary* for plan members and 7.0% of the excess for the Province. The contribution rate for the Province must equal or exceed the rate payable by plan members and is set by the Minister of Finance, taking into account recommendations of the Unregistered Plan's actuary. If assets held in the Unregistered Plan are insufficient to pay for benefits as they become due, the amount due is payable by the Province.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 6 (continued)**

A summary of the net assets available for benefits for the Unregistered Plan as at March 31, 2005 and changes in net assets available for benefits for the year then ended is as follows:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Cash and cash equivalents | $ 3,833 | $ 2,931 |
| Income tax refundable | 4,598 | 3,578 |
| Accounts (payable) receivable, net (b) | (43) | 240 |
| | 8,388 | 6,749 |
| Liabilities | | |
| Actuarial value of accrued benefits | 47,749 | 38,295 |
| Excess of liabilities over assets | (39,361) | (31,546) |
| Reserve Fund (a) (b) | 38,831 | 31,846 |
| **Net (liabilities) assets** | $ (530) | $ 300 |

(a) Contributions from the Province of Alberta as determined by the Minister of Finance based on recommendations by the Unregistered Plan's actuary are collected and held in the Provincial Judges and Masters in Chambers Reserve Fund. These contributions are invested by the Province to meet future benefit payments of the Unregistered Plan over the long term.

(b) Additional contributions from the Province of Alberta to retire unfunded liabilities of the Unregistered Plan are deposited into the Reserve Fund in 2004-05. Comparative figures have been restated to be consistent with 2004-05 presentation.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 6 (continued)**

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| **Increase in assets** | | |
| Current and optional service | | |
| Provincial Judges and Masters in Chambers | $ 1,092 | $ 806 |
| Province of Alberta | 1,092 | 806 |
| Investment income | 83 | 83 |
| | 2,267 | 1,695 |
| **Decrease in assets** | | |
| Increase in actuarial value of accrued benefits | (9,454) | (6,837) |
| Pension benefits | (556) | (431) |
| Administration costs | (72) | (67) |
| | (10,082) | (7,335) |
| Increase in the Reserve Fund | 6,985 | 5,361 |
| **Increase in net assets** | (830) | (279) |
| **Net assets at beginning of year** | 300 | 579 |
| **Net (liabilities) assets at end of year** | $ (530) | $ 300 |

An actuarial valuation for the Unregistered Plan was carried out as at March 31, 2003 by Johnson Inc. and was extrapolated to March 31, 2005. The 2003 valuation was determined using the projected benefit method prorated on service. The assumptions used in the valuation and extrapolation were developed as the best estimate of expected short-term and long-term market conditions and other future events. The 2005 extrapolation took into account the impact of the increase in the *yearly maximum pension accruals limit* for defined benefit pension as announced in the Federal Budget 2005. After consultation with the Unregistered Plan's actuary, the Plan's management approved these best estimates.

The major assumptions used in the actuarial valuation were the same as those used in the valuation of the Registered Plan (see Note 7).

The Unregistered Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Unregistered Plan.

## NOTE 7 ACCRUED BENEFITS

### (a) Actuarial Valuation

An actuarial valuation of the Registered Plan was carried out as at March 31, 2003 by Johnson Inc. and was then extrapolated to March 31, 2005. The 2003 valuation was determined using the projected benefit method based on service. The assumptions used in the valuation were developed as the best estimate of expected short-term and long-term market conditions and other future events. The 2005 extrapolation took into account the impact of the increase in the *yearly maximum pension accruals limit* for defined benefit pension as announced in the Federal Budget 2005. After consultation with the Registered Plan's actuary, the Plan's management approved these best estimates.

The major assumptions used were:

| | **2004 and 2005 Extrapolation** % | **2003 Valuation** % |
|---|---|---|
| Asset real rate of return | 3.5 | 3.5 |
| Inflation rate | 3.0 | 3.0 |
| Investment return | 6.5 | 6.5 |
| Salary escalation rate | 4.0 | 4.0 |
| Pension cost of living increase as a percentage of Alberta Consumer Price Index | 60 | 60 |

The following statement shows the principal components of the change in the value of accrued pension benefits:

| | **2005** | **2004** |
|---|---|---|
| **Accrued pension benefits at beginning of year** | $ 79,453 | $ 75,652 |
| Interest accrued on benefits | 5,164 | 4,917 |
| Additional cost due to salary increase | - | 1,717 |
| Other experience gains, net | (411) | (1,651) |
| Benefits earned | 3,290 | 2,408 |
| Net benefits paid | (3,871) | (3,590) |
| **Accrued pension benefits at end of year** | $ 83,625 | $ 79,453 |

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

**NOTE 7 (continued)**

**(b) Sensitivity of Changes in Major Assumptions**

The Registered Plan's future experience will inevitably differ, perhaps significantly, from these assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Registered Plan. The following is a summary of the sensitivities of the Registered Plan's deficiency and current service cost to changes in assumptions used in the actuarial valuation at March 31, 2005:

| | | Sensitivities | |
|---|---|---|---|
| | Changes in Assumptions % | Increase in Plan Deficiency ($ millions) | Increase in Current Service Cost as % of Capped Pensionable Earnings * |
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 5.5 | 1.3% |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 0.2 | 0.0% |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant | (1.0%) | 9.5 | 1.8% |

* The current service cost as % of capped pensionable earnings as determined by the 2003 valuation is 21.03%.

## NOTE 8 ACTUARIAL DEFICIENCY

The actuarial deficiency of the Registered Plan as of any particular valuation date is funded by additional contributions from the Province over a period not exceeding 15 years.

Based on an actuarial valuation of the Registered Plan as at March 31, 2003, the Registered Plan's actuary has recommended the actuarial deficiency be funded by additional annual contribution of $1,172,000 from the Province over 15 years.

Any assets remaining in the Registered Plan after all benefits are paid on complete wind-up must be returned to the Province of Alberta.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## NOTE 9 NET INVESTMENT INCOME

Net investment income is comprised of the following:

*(thousands)*

| | 2005 | 2004 |
|---|---|---|
| Net realized and unrealized gains (losses) on investments including those arising from derivative transactions | $ 2,555 | $ 11,171 |
| Interest income | 2,335 | 2,078 |
| Dividend income | 640 | 579 |
| Real estate income | 237 | 243 |
| Securities lending income | 16 | 17 |
| Pooled funds management and associated custodial fees | (103) | (74) |
| | $ 5,680 | $ 14,014 |

The following is a summary of the Registered Plan's net investment income by type of investments:

| | 2005 | 2004 |
|---|---|---|
| Fixed Income Securities | $ 1,891 | $ 3,286 |
| Canadian Equities | 2,328 | 4,526 |
| Foreign Equities | | |
| United States | (207) | 2,091 |
| Non-North American | 945 | 3,798 |
| Real Estate | 723 | 313 |
| | $ 5,680 | $ 14,014 |

## NOTE 10 ADMINISTRATION EXPENSES

Administration expenses comprise $28,000 (2004 $23,000) investment management and $65,000 (2004 $63,000) in general administration costs. These expenses were paid to Alberta Finance and Alberta Pensions Administration Corporation respectively on a cost-recovery basis. Pooled funds management and associated custodial fees totalling $103,000 (2004 $74,000), which have been deducted from investment income of the pools, are excluded from administration expenses (see Note 9).

## NOTE 11 COMPARATIVE FIGURES

Comparative figures have been reclassified to be consistent with 2005 presentation.

## NOTE 12 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

# SCHEDULES TO THE PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENT RETURNS — Schedule A

Year Ended March 31, 2005

The Plan uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Plan over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Investment returns and the relevant benchmarks for the Plan for the one-year and four-year periods ended March 31, 2005 are as follows:

| | One Year Return | | | | 4 Year Compound Annualized |
|---|---|---|---|---|---|
| | **2005** | **2004** | **2003** | **2002** | **Return** |
| **Time-weighted rates of return** | | | | | |
| Short-term fixed income | 2.4 | 3.0 | 2.9 | 3.9 | 3.1 |
| *Scotia Capital 91-Day T-Bill Index* | *2.2* | *3.0* | *2.7* | *3.7* | *2.9* |
| Long-term fixed income | 5.6 | 11.7 | 9.6 | 5.9 | 8.2 |
| *Scotia Capital Universe Bond Index* | *5.0* | *10.8* | *9.2* | *5.1* | *7.5* |
| Canadian equities | 15.0 | 36.7 | (17.2) | 3.7 | 7.7 |
| *S&P/TSX Composite Index* | *13.9* | *37.7* | *(17.6)* | *4.9* | *7.9* |
| United States equities | (2.1) | 22.2 | (30.4) | 2.1 | (4.0) |
| *Standard & Poor's 500 Index* | *(1.5)* | *20.5* | *(30.7)* | *1.6* | *(4.4)* |
| Non-North American equities | 7.6 | 40.9 | (29.0) | (5.7) | 0.4 |
| *MSCI EAFE Index* | *6.2* | *40.5* | *(29.3)* | *(7.3)* | *(0.6)* |
| Real estate | 17.3 | 7.5 | 9.8 | 7.2 | 10.4 |
| *Real Estate Index** | *21.3* | *8.0* | *11.5* | *9.1* | *12.4* |
| **Overall** | **7.3** | **21.8** | **(8.6)** | **3.3** | **5.4** |
| ***Policy Benchmark*** | ***6.8*** | ***21.3*** | ***(9.3)*** | ***3.1*** | ***4.9*** |

* Russell Canadian Property Index to December 31, 2002 and the IPD Large Institutional All Property Benchmark Index thereafter.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule B

Year Ended March 31, 2005 *(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 1,093 | $ 1,390 |
| **Fixed Income Securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 8,733 | 6,710 |
| Provincial, direct and guaranteed | | |
| Alberta | 18 | 21 |
| Other | 7,066 | 6,996 |
| Municipal | 371 | 382 |
| Corporate, public and private | 17,670 | 18,783 |
| | 33,858 | 32,892 |
| Receivable from sale of investments and accrued investment income | 405 | 353 |
| Liabilities for investment purchases | (170) | (399) |
| | 235 | (46) |
| | $ 35,186 | $ 34,236 |

(a) Fixed income securities held as at March 31, 2005 had an average effective market yield of 4.59% (2004 4.39%) per annum. The following term structure of these securities as at March 31, 2005 is based on principal amount:

| | 2005 % | 2004 % |
|---|---|---|
| under 1 year | 3 | 3 |
| 1 to 5 years | 35 | 37 |
| 6 to 10 years | 33 | 30 |
| 11 to 20 years | 12 | 11 |
| over 20 years | 17 | 19 |
| | 100 | 100 |

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES — Schedule C

Year Ended March 31, 2005 *(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 125 | $ 122 |
| **Public Equities (a) (b)** | | |
| Consumer discretionary | 1,055 | 1,124 |
| Consumer staples | 719 | 634 |
| Energy | 3,369 | 2,260 |
| Financial | 5,315 | 4,873 |
| Health care | 224 | 346 |
| Industrials | 888 | 1,219 |
| Information technology | 894 | 1,223 |
| Materials | 2,359 | 2,589 |
| Telecommunication services | 1,028 | 726 |
| Utilities | 231 | 506 |
| | 16,082 | 15,500 |
| Small Cap pooled fund | 288 | 6 |
| | 16,370 | 15,506 |
| **Private Equities** | 115 | 128 |
| Receivable from sale of investments and accrued investment income | 269 | 64 |
| Liabilities for investment purchases | (179) | (186) |
| | 90 | (122) |
| | $ 16,700 | $ 15,634 |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $6,519,000 (2004 $4,914,000), which were used as underlying securities to support the notional amount of Canadian equity index swap contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES Schedule D

Year Ended March 31, 2005 *(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 301 | $ 308 |
| **Public Equities (a) (b)** | | |
| Consumer discretionary | 1,517 | 1,800 |
| Consumer staples | 1,207 | 1,099 |
| Energy | 1,120 | 653 |
| Financial | 2,604 | 2,302 |
| Health care | 1,664 | 1,359 |
| Industrials | 1,614 | 1,269 |
| Information technology | 1,939 | 1,762 |
| Materials | 502 | 417 |
| Telecommunication services | 355 | 324 |
| Utilities | 456 | 260 |
| | 12,978 | 11,245 |
| Receivable from sale of investments and accrued investment income | 58 | 70 |
| Liabilities for investment purchases | (235) | (347) |
| | (177) | (277) |
| | $ 13,102 | $ 11,276 |

(a) The Plan's net investment in United States public equities includes the fair value of deposits and floating rate notes, totalling $7,575,000 (2004 $3,838,000), which were used as underlying securities to support the notional amount of U.S. equity index swaps and futures contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule E

Year Ended March 31, 2005 *(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 323 | $ 354 |
| **Public Equities (a) (b)** | | |
| Consumer discretionary | 1,670 | 1,885 |
| Consumer staples | 737 | 918 |
| Energy | 1,061 | 928 |
| Financial | 3,360 | 2,911 |
| Health care | 757 | 941 |
| Industrials | 1,487 | 1,384 |
| Information technology | 631 | 759 |
| Materials | 1,105 | 949 |
| Telecommunication services | 1,077 | 963 |
| Utilities | 548 | 475 |
| | 12,433 | 12,113 |
| Emerging market equity pools | 376 | - |
| Receivable from sale of investments and accrued investment income | 148 | 261 |
| Liabilities for investment purchases | (175) | (321) |
| | (27) | (60) |
| | $ 13,105 | $ 12,407 |

(a) The Plan's net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $1,663,000 (2004 $1,755,000), which were used as underlying securities to support the notional amount of Non-North American equity index swaps.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's S&P 500 Index. The following is a summary of the Plan's share of Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased:

*(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| United Kingdom | $ 2,696 | $ 2,786 |
| Japan | 2,120 | 2,308 |
| France | 1,223 | 1,141 |
| Germany | 876 | 820 |
| Switzerland | 778 | 953 |
| Netherlands | 671 | 659 |
| Australia | 559 | 593 |
| Italy | 474 | 536 |
| Spain | 361 | 322 |
| Sweden | 332 | 229 |
| Other | 2,343 | 1,766 |
| | $ 12,433 | $ 12,113 |

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (REGISTERED) PENSION PLAN

## SCHEDULE OF INVESTMENTS IN REAL ESTATE — Schedule F

Year Ended March 31, 2005 *(thousands)*

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| **Deposits and short-term securities** | $ 2 | $ 5 |
| **Real estate (a)** | | |
| Office | 2,176 | 1,946 |
| Retail | 1,938 | 1,852 |
| Industrial | 378 | 291 |
| Residential | 216 | 229 |
| | 4,708 | 4,318 |
| Passive index | 69 | 39 |
| Receivable from sale of investments and accrued investment income | 6 | 11 |
| | $ 4,785 | $ 4,373 |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

| | Plan's Share 2005 | Plan's Share 2004 |
|---|---|---|
| Ontario | $ 3,133 | $ 3,195 |
| Alberta | 978 | 1,034 |
| Quebec | 495 | - |
| British Columbia | 102 | 89 |
| | $ 4,708 | $ 4,318 |

# PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

AUDITOR GENERAL Alberta

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the Statement of Accrued Benefits and Net Assets Available for Benefits of the Public Service Management (Closed Membership) Pension Plan (the Plan) as at December 31, 2004 and the Statement of Changes in Net Assets Available for Benefits for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Accrued Benefits and Net Assets Available for Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta — Fred J. Dunn, FCA

March 4, 2005 — Auditor General

PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

## STATEMENT OF ACCRUED BENEFITS AND NET ASSETS AVAILABLE FOR BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Accrued Benefits** | | |
| Actuarial value of accrued pension benefits (Note 5) | $ 661,418 | $ 680,472 |
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Cash and cash equivalents (Note 3) | 672 | 2,073 |
| Accounts receivable | 88 | 119 |
| | 760 | 2,192 |
| Liabilities | | |
| Accounts payable | 6 | 2 |
| **Net assets available for benefits** | 754 | 2,190 |
| **Excess of actuarial value of accrued pension benefits over net assets** | $ 660,664 | $ 678,282 |

*See accompanying notes.*

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in assets** | | |
| Contributions from the Province of Alberta | $ 57,000 | $ 57,057 |
| Investment income | 54 | 60 |
| | 57,054 | 57,117 |
| **Decrease in assets** | | |
| Pension benefits | 58,138 | 56,980 |
| Administration expenses (Note 4) | 352 | 409 |
| Refunds and transfer to members | - | 62 |
| | 58,490 | 57,451 |
| **Decrease in net assets** | (1,436) | (334) |
| **Net assets available for benefits at beginning of year** | 2,190 | 2,524 |
| **Net assets available for benefits at end of year** | $ 754 | $ 2,190 |

*See accompanying notes.*

PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Public Service Management (Closed Membership) Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000.

**(a) General**

The Plan is a defined benefit pension plan for eligible retired management employees of the Province of Alberta and certain provincial agencies and public bodies. Members of the former Public Service Management Pension Plan who were retired or were entitled to receive deferred pensions or had attained 35 years of service before August 1, 1992 continue as members of this Plan. The Plan is a registered pension plan as defined in the *Income Tax Act*, and is not subject to income taxes. The Plan's registration number is 1006923.

**(b) Funding Policy**

The Plan is funded by investment income and money appropriated to the Plan, if any, by the Legislative Assembly of the Province of Alberta.

The Plan's actuary performs an actuarial valuation of the Plan at least once every three years.

**(c) Retirement Benefits**

The Plan provides for a pension of 2.0% for each year of pensionable service based on the average salary of the highest five consecutive years. The maximum service allowable under the Plan is 35 years.

Members are entitled to receive a pension if they terminated before August 1, 1992 and attained age 55 with at least five years of service. In addition, those members who had achieved 35 years of service at August 1, 1992 and subsequently terminated are also entitled to a pension.

**(d) Cost-of-Living Adjustments**

Pensions payable by the Plan are increased on January 1st of each year by an amount equal to at least 60 percent of the average of the increases in the Alberta Consumer Price Index in the twelve-month period ending on October 31st of the previous year.

**(e) Guarantee**

The Province of Alberta guarantees payment of all benefits arising under the Plan. After all assets in the Plan are exhausted, the Province of Alberta pays all benefits under the Plan and the plan costs.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles (see Note 1 (e)). The statements provide information about the net assets available in the Plan to meet future benefit payments, and are prepared to assist plan members and others in reviewing the activities of the Plan for the year.

**(b) Valuation of Assets and Liabilities**

Short-term securities included in cash and cash equivalents are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Investment income is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's actuarial value of accrued pension benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Plan's actuarial value of accrued pension benefits, management considers that it is possible, based on existing knowledge, that changes in future conditions in the short term could require a material change in the recognized amounts. Differences between actual results and expectations are disclosed as changes in actuarial assumptions and net experience gains or losses in the note describing changes in the actuarial value of accrued pension benefits (see Note 5(a)).

PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

## NOTE 3 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist primarily of deposits in the Consolidated Cash Investment Trust Fund. The Fund is managed with the objectives of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. As at December 31, 2004, securities held by the Fund have an average effective market yield of 2.6% per annum (2003 2.4% per annum) and an average duration of 125 days (2003 98 days).

## NOTE 4 ADMINISTRATION EXPENSES

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| General administration costs | $ 340 | $ 377 |
| Investment management costs | 8 | 17 |
| Actuarial fees | 4 | 15 |
| | $ 352 | $ 409 |

General administration costs were paid to Alberta Pensions Administration Corporation on a cost-recovery basis.

Investment management costs were paid to Alberta Finance, and do not include custodial fees, which have been deducted in arriving at investment income.

Total administration expenses amounted to $135 per member (2003 $155 per member).

## NOTE 5 ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS

### (a) Actuarial Valuation

An actuarial valuation of the Plan was carried out as at December 31, 2002 by Aon Consulting Inc. and was extrapolated to December 31, 2004.

Actuarial valuations were determined using the projected benefit method prorated on service. The assumptions used in the valuations and extrapolations were developed as the best estimate of expected short-term and long-term market conditions and other future events. After consultation with the Plan's actuary, the Board approved these best estimates.

PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

**NOTE 5 (continued)**

The major assumptions used were as follows:

| | 2004 Extrapolation % | 2002 Valuation and 2003 Extrapolation % |
|---|---|---|
| Asset real rate of return | 3.0 | 3.0 |
| Inflation rate | 3.0 | 3.0 |
| Investment rate of return | 6.0 | 6.0 |
| Mortality rate | 1994 Uninsured Pensioner Table | |

The following statement shows the principal components of the change in the actuarial value of accrued pension benefits.

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Actuarial value of accrued pension benefits at beginning of year** | $ 680,472 | $ 622,461 |
| Interest accrued on benefits | 39,084 | 40,132 |
| Net benefits paid | (58,138) | (57,041) |
| Changes in actuarial assumptions | - | 78,181 |
| Net experience gains | - | (3,261) |
| **Actuarial value of accrued pension benefits at end of year** | $ 661,418 | $ 680,472 |

PUBLIC SERVICE MANAGEMENT (CLOSED MEMBERSHIP) PENSION PLAN

**NOTE 5 (continued)**

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from these assumptions. Any differences between the actuarial assumptions and future experience will emerge as gains and losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's deficiency to changes in assumptions used in the actuarial extrapolation at December 31, 2004:

| | Sensitivities | |
|---|---|---|
| | **Changes in Assumptions %** | **Increase in Plan Deficiency ($ million)** |
| Inflation rate increase holding the nominal investment return assumption constant | 1.0% | $ 38 |
| Investment rate of return decrease holding the inflation rate assumption constant | (1.0%) | 57 |

## NOTE 6 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were prepared by management and approved by the Management Employees Pension Board.

# PUBLIC SERVICE PENSION PLAN

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

AUDITOR GENERAL
Alberta

# AUDITOR'S REPORT

**To the Public Service Pension Board**

I have audited the Statement of Net Assets Available for Benefits and Liability for Accrued Benefits of the Public Service Pension Plan (the Plan) as at December 31, 2004 and the Statements of Changes in Net Assets Available for Benefits, Changes in Liability for Accrued Benefits and Changes in Deficiency for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits and Liability for Accrued Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits, Changes in Liability for Accrued Benefits and Changes in Deficiency for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
March 23, 2005

PUBLIC SERVICE PENSION PLAN

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND LIABILITY FOR ACCRUED BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net assets available for benefits** | | |
| Assets | | |
| Investments (Note 3) | $ 4,465,432 | $ 4,052,748 |
| Contributions receivable (Note 6) | 15,185 | 14,531 |
| Accrued investment income and accounts receivable | 1,892 | 4,862 |
| | 4,482,509 | 4,072,141 |
| Liabilities | | |
| Accounts payable | 1,577 | 1,354 |
| Net assets available for benefits | 4,480,932 | 4,070,787 |
| **Liability for accrued benefits** | | |
| Actuarial value of accrued benefits | 4,931,000 | 4,655,000 |
| **Deficiency (Notes 10 and 11)** | $ (450,068) | $ (584,213) |

*See accompanying notes and schedules.*

PUBLIC SERVICE PENSION PLAN

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in assets** | | |
| Net investment income (Note 8) | $ 395,179 | $ 541,156 |
| Contributions | | |
| Current and optional service | | |
| Employers | 104,404 | 82,062 |
| Employees | 106,816 | 83,387 |
| Transfers from other plans | 4,302 | 425 |
| | 610,701 | 707,030 |
| **Decrease in assets** | | |
| Pension benefits | 170,971 | 162,700 |
| Refunds to members | 18,770 | 13,357 |
| Transfers to other plans | 3,770 | 423 |
| Plan expenses (Note 9) | 7,045 | 7,300 |
| Net transfer to the Local Authorities Pension Plan | - | 13,935 |
| | 200,556 | 197,715 |
| **Increase in net assets** | 410,145 | 509,315 |
| **Net assets available for benefits at beginning of year** | 4,070,787 | 3,561,472 |
| **Net assets available for benefits at end of year** | $ 4,480,932 | $ 4,070,787 |

*See accompanying notes and schedules.*

PUBLIC SERVICE PENSION PLAN

## STATEMENT OF CHANGES IN LIABILITY FOR ACCRUED BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in liability for accrued benefits** | | |
| Interest accrued on benefits | $ 325,000 | $ 303,000 |
| Benefits earned | 168,000 | 154,000 |
| Changes in actuarial assumptions | - | 145,000 |
| Net experience losses | - | 121,000 |
| Adjustment for higher than assumed cost-of-living increases in 2004 | - | 28,000 |
| | 493,000 | 751,000 |
| **Decrease in liability for accrued benefits** | | |
| Benefits paid | 194,000 | 176,000 |
| Net experience gains | 23,000 | - |
| Transfer to the Local Authorities Pension Plan | - | 13,000 |
| | 217,000 | 189,000 |
| **Net increase in liability for accrued benefits** | 276,000 | 562,000 |
| **Liability for accrued benefits at beginning of year** | 4,655,000 | 4,093,000 |
| **Liability for accrued benefits at end of year (Note 7)** | $ 4,931,000 | $ 4,655,000 |

## STATEMENT OF CHANGES IN DEFICIENCY

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Deficiency at beginning of year (Notes 10 and 11)** | $ (584,213) | $ (531,528) |
| Increase in net assets available for benefits | 410,145 | 509,315 |
| Net increase in liability for accrued benefits | (276,000) | (562,000) |
| **Deficiency at end of year (Notes 10 and 11)** | $ (450,068) | $ (584,213) |

*See accompanying notes and schedules.*

PUBLIC SERVICE PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Public Service Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000 and Alberta Regulation 368/93, as amended.

**(a) General**

The Plan is a contributory defined benefit pension plan for eligible employees of the Province of Alberta, approved provincial agencies and public bodies. The Plan is a registered pension plan as defined in the *Income Tax Act.* The Plan's registration number is 0208769.

**(b) Funding Policy**

Current service costs and the Plan's actuarial deficiency (see Note 10) are funded equally by employers and employees at rates, which together with investment earnings, are expected to provide for all benefits payable under the Plan. The rates in effect at December 31, 2004 were unchanged at 6.17% of pensionable salary up to the Canada Pension Plan's Year's Maximum Pensionable Earnings (YMPE) and 8.81% of the excess for employees. Employers provide matching contributions. The rates are to be reviewed at least once every three years by the Board based on recommendations of the Plan's actuary.

**(c) Retirement Benefits**

The Plan provides a pension of 1.4% for each year of pensionable service based on average salary of the highest five consecutive years up to the YMPE and 2.0% on the excess, subject to the maximum benefit limit allowed under the federal *Income Tax Act*. The maximum service allowable under the Plan is 35 years. Pensions are payable to members at retirement who have attained age 65, or have attained age 55 and the sum of their age and years of service equals 85. Reduced pensions are payable to members at age 55 or older retiring early with a minimum of two years of service.

**(d) Termination Benefits**

Members who terminate with at least two years of service and are not immediately entitled to a pension may receive the commuted value of their pension for all service which is subject to lock-in provisions. Alternatively, they may elect to receive a deferred pension. Members who terminate with less than two years of service receive a refund of their contributions and interest.

**(e) Disability Benefits**

Unreduced pensions are payable to members who become totally disabled and have at least two years of service. Reduced pensions are payable to members who become partially disabled and have at least two years of service.

PUBLIC SERVICE PENSION PLAN

**NOTE 1 (continued)**

**(f) Death Benefits**

Death benefits are payable on the death of a member. If the member has at least two years of service, a surviving pension partner may choose to receive a survivor pension. For a beneficiary other than a pension partner or where service is less than two years, a lump sum payment must be chosen.

**(g) Optional Service and Transfers**

All optional service purchases are to be cost-neutral to the Plan.

Reciprocal agreements provide that transferred-in service be on an actuarial reserve basis and transfers-out receive the commuted value for all service.

**(h) Cost-of-Living Adjustments**

Pensions payable are increased on January 1st each year by an amount equal to at least 60% of the average of the increases in the Alberta Consumer Price Index during the twelve-month period ending on October 31st of the previous year.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist Plan members and others in reviewing the activities of the Plan for the year.

Except for real rate of return bonds which are held directly by the Plan, Plan investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Plan or by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

PUBLIC SERVICE PENSION PLAN

**NOTE 2 (continued)**

Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

The fair value of alternative investments including investments in private investment funds, private equities and securities with limited marketability is estimated by Alberta Finance or external managers appointed by Alberta Finance using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Real estate investments are reported at their most recent appraised value net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market index net of accrued floating rate interest.

PUBLIC SERVICE PENSION PLAN

**NOTE 2 (continued)**

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index future contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's liability for accrued benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Plan's liability for accrued benefits, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are disclosed as assumption or other changes and net experience gains or losses in the statement of changes in liability for accrued benefits.

PUBLIC SERVICE PENSION PLAN

## NOTE 3 INVESTMENTS (SCHEDULES A TO E)

*(thousands)*

| | 2004 Fair Value | % | 2003 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 76,956 | 1.7 | $ 62,826 | 1.6 |
| Canadian Dollar Public Bond Pool (b) | 993,226 | 22.2 | 875,253 | 21.6 |
| Real rate of return bonds (c) | 256,764 | 5.8 | 237,233 | 5.8 |
| Private Mortgage Pool (d) | 170,039 | 3.8 | 156,768 | 3.9 |
| Total fixed income securities | 1,496,985 | 33.5 | 1,332,080 | 32.9 |
| **Canadian Equities (Schedule B)** | | | | |
| External Managers | | | | |
| Canadian Large Cap Equity Pool (e) | 378,856 | 8.5 | 374,263 | 9.2 |
| Canadian Small Cap Equity Pool (e) | 70,020 | 1.6 | 63,886 | 1.6 |
| Domestic Passive Equity Pooled Fund (f) | 269,958 | 6.0 | 255,526 | 6.3 |
| Canadian Pooled Equities Fund (g) | 136,179 | 3.1 | 131,234 | 3.2 |
| | 855,013 | 19.2 | 824,909 | 20.3 |
| **United States Equities (Schedule C)** | | | | |
| US Passive Equity Pooled Fund (h) | 510,609 | 11.4 | 411,461 | 10.2 |
| External Managers | | | | |
| US Large Cap Equity Pool (i) | 333,901 | 7.5 | 327,798 | 8.1 |
| US Mid/Small Cap Equity Pool (i) | 64,024 | 1.4 | 52,654 | 1.3 |
| S&P 500 Pooled Index Fund (h) | 865 | - | 836 | - |
| | 909,399 | 20.3 | 792,749 | 19.6 |
| **Non-North American Equities (Schedule D)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (j) | 501,067 | 11.2 | 486,188 | 12.0 |
| EAFE Plus Equity Pool (j) | 248,604 | 5.6 | 218,803 | 5.4 |
| Emerging Markets Equity Pool (k) | 47,421 | 1.1 | - | - |
| EAFE Passive Equity Pool | - | - | 901 | - |
| EAFE Structured Equity Pooled Fund (l) | 125,722 | 2.8 | 158,699 | 3.9 |
| | 922,814 | 20.7 | 864,591 | 21.3 |
| **Alternative Investments - Equities** | | | | |
| Private Equity 2002 , Private Equity 2004 and Private Income Pool (m) | 22,572 | 0.5 | 3,465 | 0.1 |
| **Real Estate Equities (Schedule E)** | | | | |
| Private Real Estate Pool (n) | 258,649 | 5.8 | 234,954 | 5.8 |
| Total equities | 2,968,447 | 66.5 | 2,720,668 | 67.1 |
| **Total investments** | $ 4,465,432 | 100.0 | $ 4,052,748 | 100.0 |

PUBLIC SERVICE PENSION PLAN

**NOTE 3 (continued)**

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) Real rate of return bonds are issued or guaranteed by the Government of Canada and bear interest at a fixed rate adjusted for inflation.

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. To limit investment risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(e) The External Managers Canadian Large Cap and Small Cap Equity Pools consist of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap or small cap equity markets. The Small Cap Pool is restricted to invest in publicly traded Canadian equities with a market capitalization of up to 0.15% of the Toronto Stock Exchange S&P/TSX Composite Index total market capitalization at time of purchase. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

(f) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(g) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index over a four-year period while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection and sector rotation.

(h) The US Passive Equity Pooled Fund and the S&P 500 Pooled Index Fund are passively managed. The portfolios are comprised of publicly traded United States equities similar in weights to the Standard & Poor's S&P 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. The pools utilize a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pools also invest in futures, swaps and other structured investments.

(i) The External Managers US Large Cap Equity Pool consists of multiple portfolios and the External Managers US Mid/Small Cap Equity Pool consists of a single portfolio of publicly traded United States equities. Each portfolio is actively managed by an external manager with expertise in the US large cap or mid/small cap equity markets. The performance objective is to provide returns higher than the total return of the S&P 500 Index for the US Large Cap Pool and the Russell 2500 Index for the US Mid/Small Cap Pool over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

PUBLIC SERVICE PENSION PLAN

**NOTE 3 (continued)**

(j) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with fewer constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

(k) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) Emerging Markets Free (EMF) Index over a four-year period.

(l) The EAFE Structured Equity Pooled Fund's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The pooled fund is internally managed and provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

(m) The Private Equity Pool 2002 and Private Equity Pool 2004 are managed with the objective of providing investment returns comparable to the S&P/TSX Composite Index plus 2.5% over the long term. The pools invest in institutionally sponsored Canadian private equity pools managed by experienced advisors with proven records. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool is managed with the objective of providing an investment return comparable to the Consumer Price Index plus 6% over the long term. The pool invests in infrastructure related projects that are structured to provide high current income.

(n) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediary companies which have issued to the pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Plan are primarily affected by the long-term real rate of return expected to be earned on investments. The expected rate of return on investments, together with the expected long term inflation rate, form the basis for determining the economic assumptions used in calculating the actuarial liabilities. In order to earn the best possible return at an acceptable level of risk, the Board has established a target policy asset mix of 35% fixed income instruments and 65% equities. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

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## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Plan's proportionate share of the notional amount and net fair value of derivative contracts held by pooled funds at December 31, 2004:

| *(thousands)* | Maturity | | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Net Fair Value (a) | Notional Amount | Net Fair Value (a) |
| | | % | | | | | |
| Equity index swap contracts | 78 | 22 | - | $ 782,631 | $31,381 | $ 718,889 | $ 30,463 |
| Cross-currency interest rate swap contracts | 32 | 29 | 39 | 305,571 | (19,931) | 266,404 | (28,887) |
| Interest rate swap contracts | 38 | 57 | 5 | 303,180 | (12,690) | 319,818 | (16,567) |
| Forward foreign exchange contracts | 100 | - | - | 115,135 | 154 | 224,034 | 2,713 |
| Credit default swap contracts | 17 | 18 | 65 | 87,180 | 309 | 12,150 | (149) |
| Bond index swap contracts | 100 | - | - | 19,363 | 376 | 14,096 | 20 |
| Equity index futures contracts | 100 | - | - | 18,210 | 2,080 | 11,402 | 1,394 |
| | | | | $1,631,270 | $ 1,679 | $1,566,793 | $(11,013) |

(a) The method of determining fair value of derivative contracts is described in Note 2 (e).

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

PUBLIC SERVICE PENSION PLAN

## NOTE 6 CONTRIBUTIONS RECEIVABLE
*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Employers | $ 7,590 | $ 7,278 |
| Employees | 7,595 | 7,253 |
| | $ 15,185 | $ 14,531 |

## NOTE 7 ACCRUED BENEFITS

### (a) Actuarial Valuation

` An actuarial valuation of the Plan was carried out as at December 31, 2002 by Aon Consulting Inc. and was then extrapolated to December 31, 2004.

Actuarial valuations were determined using the projected benefit method, based on service. The assumptions used in the valuations and extrapolations were developed as the best estimates of expected short-term and long-term market conditions and other future events. After consultation with the Plan's actuary, the Board approved these best estimates.

The major assumptions used were:

| | December 31 | |
|---|---|---|
| | 2004 Extrapolation % | 2002 Valuation and 2003 Extrapolation % |
| Investment rate of return | 7.00 | 7.00 |
| Inflation rate | 3.25 | 3.25 |
| Salary escalation rate* | 3.75 | 3.75 |
| Pension cost of living increase as a percentage of Alberta Consumer Price Index | 60.00 | 60.00 |

* In addition to merit and promotion.

PUBLIC SERVICE PENSION PLAN

**NOTE 7 (continued)**

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation and extrapolation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's deficiency and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2004:

| | | Sensitivities | |
|---|---|---|---|
| | **Changes in Assumptions %** | **Increase in Plan Deficiency ($ millions)** | **Increase in Current Service Cost as a % of Pensionable Earnings *** |
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 308 | 0.55% |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 250 | 1.06% |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant | (1.0%) | 794 | 2.60% |

* The current service cost as a % of pensionable earnings as determined by the December 31, 2002 valuation was 10.46%.

## NOTE 8 NET INVESTMENT INCOME

Net investment income of the Plan is comprised of the following:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Net realized and unrealized gains on investments, including those arising from derivative transactions | $ 244,565 | $ 406,551 |
| Interest income | 105,326 | 92,827 |
| Dividend income | 37,930 | 32,478 |
| Real estate income | 13,241 | 12,753 |
| Securities lending income | 1,081 | 1,058 |
| Pooled funds management and associated custodial fees | (6,964) | (4,511) |
| | $ 395,179 | $ 541,156 |

PUBLIC SERVICE PENSION PLAN

**NOTE 8 (continued)**

The following is a summary of the Plan's proportionate share of net investment income by type of investments:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Fixed Income Securities | $ 128,371 | $ 101,117 |
| Canadian Equities | 116,706 | 172,446 |
| Foreign Equities | | |
| United States | 24,778 | 130,639 |
| Non-North American | 100,411 | 114,968 |
| Alternative Investments - Equities | 86 | (1) |
| Real Estate Equities | 24,827 | 21,987 |
| | $ 395,179 | $ 541,156 |

The following is a summary of the investment performance results attained by the Plan:

| | One Year Return | Four-Year Compound Annualized Return | Eight-Year Compound Annualized Return |
|---|---|---|---|
| **Time-weighted rates of return*** | | | |
| Overall Plan | 9.7% | 3.2% | 7.0% |
| Policy Benchmark** | 9.4% | 2.8% | 6.8% |

* The measure involves the calculation of the net return realized by the Plan over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains and losses (realized and unrealized).

** The policy benchmark return is a product of the weighted average policy sector weights and sector returns.

## NOTE 9 PLAN EXPENSES

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| General administration costs | $ 5,780 | $ 6,118 |
| Investment management costs | 762 | 721 |
| Board costs | 180 | 192 |
| Actuarial fees | 95 | 112 |
| Other professional fees | 228 | 157 |
| | $ 7,045 | $ 7,300 |

General administration and Board costs were paid to Alberta Pensions Administration Corporation on a cost-recovery basis.

PUBLIC SERVICE PENSION PLAN

**NOTE 9 (continued)**

Investment management costs were paid to Alberta Finance and do not include pooled funds management and associated custodial fees, which have been included in the calculation of net investment income (see Note 8).

In 2004, total Plan expenses of $7,045,000 amounted to $109 per member (2003 $117 per member).

## NOTE 10 FUNDING VALUATION AND EXTRAPOLATION

The Plan's deficiency is determined on the fair value basis for accounting purposes. For funding valuation and extrapolation purposes, asset values are adjusted for fluctuations in fair values to moderate the effect of market volatility on the Plan's funded status. Actuarial asset values for funding extrapolation purposes amounted to $4,303 million at December 31, 2004 (2003 $4,059 million).

In accordance with the *Public Sector Pension Plans Act*, the actuarial deficiency of $435 million as determined by an actuarial funding valuation as at December 31, 2002 is funded by a special payment of 2.76% of pensionable earnings shared equally between employees and employers commencing on September 1, 2003 and continuing for 15 years from the date of valuation to December 31, 2017. The special payment is included in the rates in effect at December 31, 2004 (see Note 1(b)).

## NOTE 11 CHANGE IN ACCOUNTING POLICY

In order to eliminate any misunderstanding about the actual financial position of the Plan, in 2004, a change in accounting policy was introduced and assets are now valued on the fair value basis for accounting purposes with no smoothed value reported.

As at December 31, 2004, this change in accounting policy has the effect of decreasing the Plan's deficiency by $178 million. If the change had not been made, the Plan's deficiency would have been $628 million as at December 31, 2004.

This change in accounting policy has been applied retroactively and the Plan's deficiencies at December 31, 2002 and 2003 have been restated. The effect of this change in accounting policy is to increase retroactively the Plan's deficiency by $356 million at December 31, 2002 and decrease retroactively the Plan's deficiency by $12.0 million at December 31, 2003.

## NOTE 12 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2004 presentation.

## NOTE 13 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were approved by the Public Service Pension Board.

PUBLIC SERVICE PENSION PLAN

# SCHEDULES TO THE PUBLIC SERVICE PENSION PLAN

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 83,082 | $ 67,624 |
| **Fixed income securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 533,482 | 459,480 |
| Provincial | | |
| Alberta, direct and guaranteed | 627 | 669 |
| Other, direct and guaranteed | 240,187 | 140,900 |
| Municipal | 13,020 | 13,421 |
| Corporate | 370,530 | 406,378 |
| Private | | |
| Corporate | 252,037 | 242,947 |
| | 1,409,883 | 1,263,795 |
| Receivable from sale of investments and accrued investment income | 12,124 | 11,378 |
| Liabilities for investment purchases | (8,104) | (10,717) |
| | 4,020 | 661 |
| | $ 1,496,985 | $ 1,332,080 |

(a) Fixed income securities held as at December 31, 2004 had an average effective market yield of 4.00% per annum (2003 4.41% per annum). The following term structure of these securities as at December 31, 2004 was based on principal amount:

| | 2004 % | 2003 % |
|---|---|---|
| under 1 year | 2 | 2 |
| 1 to 5 years | 31 | 32 |
| 6 to 10 years | 28 | 26 |
| 11 to 20 years | 15 | 12 |
| over 20 years | 24 | 28 |
| | 100 | 100 |

PUBLIC SERVICE PENSION PLAN

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 8,265 | $ 8,645 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 66,629 | 64,610 |
| Consumer staples | 41,755 | 38,197 |
| Energy | 148,903 | 117,168 |
| Financials | 257,268 | 240,101 |
| Health care | 16,740 | 20,295 |
| Industrials | 66,917 | 84,406 |
| Information technology | 48,910 | 46,869 |
| Materials | 149,349 | 137,847 |
| Telecommunication services | 36,240 | 38,478 |
| Utilities | 5,159 | 18,807 |
| | 837,870 | 806,778 |
| Passive index | 1,119 | 1,152 |
| | 838,989 | 807,930 |
| Receivable from sale of investments and accrued investment income | 8,269 | 9,740 |
| Liabilities for investment purchases | (510) | (1,406) |
| | 7,759 | 8,334 |
| | $ 855,013 | $ 824,909 |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $192,175,000 (2003 $166,983,000) which were used as underlying securities to support the notional amount of Canadian equity index swap contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

PUBLIC SERVICE PENSION PLAN

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 28,819 | $ 31,676 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 138,892 | 122,793 |
| Consumer staples | 76,969 | 73,904 |
| Energy | 61,009 | 45,031 |
| Financials | 176,009 | 153,400 |
| Health care | 109,714 | 94,123 |
| Industrials | 113,481 | 87,851 |
| Information technology | 125,138 | 124,867 |
| Materials | 31,482 | 27,320 |
| Telecommunication services | 23,658 | 21,418 |
| Utilities | 25,038 | 18,760 |
| | 881,390 | 769,467 |
| Passive index | - | 143 |
| | 881,390 | 769,610 |
| Receivable from sale of investments and accrued investment income | 5,638 | 4,985 |
| Liabilities for investment purchases | (6,448) | (13,522) |
| | (810) | (8,537) |
| | $ 909,399 | $ 792,749 |

(a) The Plan's net investment in United States public equities includes the fair value of deposits and floating rate notes, totalling $489,975,000 (2003 $392,455,000), which were used as underlying securities to support the notional amount of U.S. equity index swaps contracts and futures contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's S&P 500 Index.

PUBLIC SERVICE PENSION PLAN

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 17,878 | $ 15,807 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 125,995 | 128,427 |
| Consumer staples | 51,246 | 66,401 |
| Energy | 76,149 | 61,864 |
| Financials | 245,104 | 205,385 |
| Health care | 53,531 | 66,407 |
| Industrials | 99,824 | 91,668 |
| Information technology | 43,420 | 50,116 |
| Materials | 72,455 | 64,445 |
| Telecommunication services | 77,277 | 76,088 |
| Utilities | 35,146 | 32,527 |
| | 880,147 | 843,328 |
| Passive index | 19,938 | 121 |
| Receivable from sale of investments and accrued investment income | 8,854 | 8,703 |
| Liabilities for investment purchases | (4,003) | (3,368) |
| | 4,851 | 5,335 |
| | $ 922,814 | $ 864,591 |

(a) The Plan's net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $118,691,000 (2003 $152,413,000), which were used as underlying securities to support the notional amount of Non-North American equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. The following is a summary of the Plan's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased:

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| United Kingdom | $ 196,246 | $ 197,395 |
| Japan | 157,555 | 141,644 |
| France | 79,874 | 84,809 |
| Germany | 61,292 | 61,421 |
| Switzerland | 59,804 | 68,020 |
| Netherlands | 48,797 | 47,916 |
| Australia | 40,819 | 44,199 |
| Italy | 36,663 | 37,017 |
| Sweden | 22,678 | 16,269 |
| Spain | 21,770 | 22,920 |
| Other | 154,649 | 121,718 |
| | $ 880,147 | $ 843,328 |

PUBLIC SERVICE PENSION PLAN

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 27 | $ 191 |
| **Real estate (a)** | | |
| Office | 129,276 | 104,191 |
| Retail | 92,834 | 98,633 |
| Industrial | 20,392 | 15,927 |
| Residential | 12,529 | 13,791 |
| | 255,031 | 232,542 |
| Passive index | 3,223 | 1,622 |
| Receivable from sale of investments and accrued investment income | 368 | 599 |
| | $ 258,649 | $ 234,954 |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| Ontario | $ 165,328 | $ 169,954 |
| Alberta | 56,540 | 57,820 |
| Quebec | 28,724 | - |
| British Columbia | 4,439 | 4,768 |
| | $ 255,031 | $ 232,542 |

# SPECIAL FORCES PENSION PLAN

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Special Forces Pension Board**

I have audited the Statement of Net Assets Available for Benefits and Accrued Benefits of the Special Forces Pension Plan (the Plan) as at December 31, 2004 and the Statements of Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits and Accrued Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits, Changes in Accrued Benefits and Changes in Deficiency for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*
Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta
March 18, 2005

SPECIAL FORCES PENSION PLAN

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND ACCRUED BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Investments (Note 3) | $ 1,154,290 | $ 1,059,607 |
| Accounts receivable (Note 6) | 2,379 | 2,400 |
| | 1,156,669 | 1,062,007 |
| Liabilities | | |
| Accounts payable | 17 | 175 |
| Net assets available for benefits | 1,156,652 | 1,061,832 |
| **Accrued Benefits** | | |
| Actuarial value of accrued benefits | | |
| Plan Fund | 1,346,949 | 1,275,387 |
| Indexing Fund | 18,056 | 13,672 |
| | 1,365,005 | 1,289,059 |
| **Deficiency (Notes 12 and 13)** | | |
| Plan Fund * | (208,353) | (227,227) |
| Indexing Fund | - | - |
| | $ (208,353) | $ (227,227) |

* The deficiency of the Plan Fund is comprised of a pre-1992 deficiency of $150,355,000 (2003 $164,709,000) and a post-1991 deficiency of $57,998,000 (2003 $62,518,000).

*See accompanying notes and schedules.*

SPECIAL FORCES PENSION PLAN

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 Plan Fund | 2004 Indexing Fund | 2004 Total | 2003 Total |
|---|---|---|---|---|
| **Increase in assets** | | | | |
| Net investment income (Note 9) | $ 99,180 | $ 1,419 | $ 100,599 | $ 121,981 |
| Contributions (Note 8) | 42,594 | 2,965 | 45,559 | 42,209 |
| | 141,774 | 4,384 | 146,158 | 164,190 |
| **Decrease in assets** | | | | |
| Pension benefits | 49,201 | - | 49,201 | 45,509 |
| Refunds and transfers | 811 | - | 811 | 486 |
| Administration expenses (Note 10) | 1,326 | - | 1,326 | 1,196 |
| | 51,338 | - | 51,338 | 47,191 |
| **Increase in net assets** | 90,436 | 4,384 | 94,820 | 116,999 |
| **Net assets available for benefits at beginning of year** | 1,048,160 | 13,672 | 1,061,832 | 944,833 |
| **Net assets available for benefits at end of year** | $ 1,138,596 | $ 18,056 | $ 1,156,652 | $ 1,061,832 |

*See accompanying notes and schedules.*

SPECIAL FORCES PENSION PLAN

## STATEMENT OF CHANGES IN ACCRUED BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | Pre-1992 | Post-1991 | 2004 Total | 2003 Total |
|---|---|---|---|---|
| **Increase in accrued benefits** | | | | |
| Interest accrued on benefits | $ 54,686 | $ 34,087 | $ 88,773 | $ 83,628 |
| Benefits earned | 327 | 35,012 | 35,339 | 32,696 |
| Cost-of-living indexing adjustments and interest | (2,216) | 4,062 | 1,846 | 8,052 |
| | 52,797 | 73,161 | 125,958 | 124,376 |
| **Decrease in accrued benefits** | | | | |
| Benefits, transfers and interest | 41,324 | 8,688 | 50,012 | 45,995 |
| **Net increase in accrued benefits** | 11,473 | 64,473 | 75,946 | 78,381 |
| **Accrued benefits at beginning of year** | 801,377 | 487,682 | 1,289,059 | 1,210,678 |
| **Accrued benefits at end of year (Note 7)** | $ 812,850 | $ 552,155 | $ 1,365,005 | $ 1,289,059 |

*See accompanying notes and schedules.*

## STATEMENT OF CHANGES IN DEFICIENCY

For the Year Ended December 31, 2004 *(thousands)*

| | Pre-1992 | Post-1991 | 2004 Total | 2003 Total |
|---|---|---|---|---|
| **Deficiency at beginning of year (Notes 12 and 13)** | $(164,709) | $(62,518) | $(227,227) | $(265,845) |
| Increase in net assets available for benefits | 25,827 | 68,993 | 94,820 | 116,999 |
| Net increase in accrued benefits | (11,473) | (64,473) | (75,946) | (78,381) |
| **Deficiency at end of year (Notes 12 and 13)** | $(150,355) | $(57,998) | $(208,353) | $(227,227) |

*See accompanying notes and schedules.*

SPECIAL FORCES PENSION PLAN

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Special Forces Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Public Sector Pension Plans Act*, Chapter P-41, Revised Statutes of Alberta 2000 and Alberta Regulation 369/93, as amended.

**(a) General**

The Plan is a contributory defined benefit pension plan for police officers employed by participating local authorities in Alberta. The Plan is a registered pension plan as defined in the *Income Tax Act*. The Plan's registration number is 0584375.

**(b) Funding Policy**

Plan Fund

Current service costs and the Plan's actuarial deficiency in respect of service after 1991 are funded by employers and employees contributions at rates which together with investment earnings are expected to provide for all benefits payable under the Plan. The rates in effect at December 31, 2004 were unchanged at 9.61% of pensionable salary for employers and 8.51% for employees. The rates are reviewed at least once every three years by the Special Forces Pension Board (the Board) based on recommendations of the Plan's actuary.

The unfunded liability for service prior to December 31, 1991 as determined by actuarial valuation is being financed by additional contributions from the Province of Alberta, employers and employees. Additional contributions are payable until December 31, 2036 unless the unfunded liability has been previously eliminated. The rates in effect at December 31, 2004 were 1.25% of pensionable salary for the Province of Alberta, and 0.75% each for employers and employees.

Indexing Fund

Benefit payment increases are funded by post-1991 cost-of-living adjustment (COLA) (see Note 1(i)) which are funded by contributions to the Indexing Fund from employers and employees. The rates in effect at December 31, 2004 were 0.75% of pensionable salary each for employers and employees. Rates are reviewed at least once every three years by the Board based on recommendations of the Plan's actuary.

Subject to the *Employment Pension Plans Act*, the Indexing Fund may receive surpluses of the Plan Fund respecting service after 1991.

**(c) Retirement Benefits**

The Plan provides for a pension of 2.0% for each year of pensionable service based on the average salary of the five highest consecutive years, subject to the maximum benefit limit allowed under the federal *Income Tax Act*. The maximum service allowable under the Plan is 35 years. Members are entitled to a pension at retirement who have attained age 65, or have attained age 55 and have at least five years of service, or have at least 25 years of service. Pensions will be reduced at the age of 65 by 0.6% of the average Canada Pension Plan's Year's Maximum Pensionable Earnings (YMPE) times years of pensionable service. The YMPE is averaged over the same five-year period as the average salary.

SPECIAL FORCES PENSION PLAN

**NOTE 1 (continued)**

For a member who has a pension partner at retirement, the normal form of pension is a Joint and Last Survivor, with 65% continuing to the pension partner if he or she survives the member.

For a member who did not have a pension partner at retirement, the normal form is a single life pension guaranteed for a five-year period.

**(d) Disability Benefits**

Pensions are payable to members who become totally disabled and retire early with at least five years of service. Reduced pensions are payable to members who become partially disabled and retire early with at least five years of service.

**(e) Death Benefits**

Benefits are payable on the death of a member before retirement. If the member had at least five years of service and there is a pension partner or dependent minor child, benefits may take the form of a survivor pension. If the member has less than five years of service, the pension partner or beneficiary is entitled to receive death benefits in the form of a lump sum payment.

**(f) Termination Benefits**

Members who terminate with at least five years of service and who are not immediately entitled to a pension may receive a refund of contributions and interest on service prior to 1992 and the commuted value of their pension for service after 1991, subject to lock-in provisions. Alternatively, they may elect to receive a deferred pension. Members who terminate with less than five years of service receive a refund of contributions and interest.

**(g) Guarantee**

Payment of all benefits arising from service before 1992 is guaranteed by the Province of Alberta.

**(h) Optional Service and Transfers**

All optional service purchases are to be cost-neutral to the Plan.

Reciprocal agreements provide that transferred-in service be on an actuarial reserve basis and transfers-out receive the greater of the termination benefits or commuted value for all service.

**(i) Cost-of-Living Adjustments (COLA)**

Cost-of-living adjustments for service before 1992 payable by the Plan Fund are increased each year by 60% of the average of the increases in the Alberta Consumer Price Index during the twelve-month period ending on October 31st of the previous year. Cost-of-living adjustments for service after 1991 are payable by the Indexing Fund at rates determined by the Board.

SPECIAL FORCES PENSION PLAN

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist plan members and others in reviewing the activities of the Plan for the year.

Plan investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Plan or by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Private fixed income securities and mortgages are valued based on the net present value of future cash flows. These cash flows are discounted using Government of Canada bond rates adjusted for a risk premium estimated by investment managers of Alberta Finance.

The fair value of alternative investments including investments in private investment funds, private equities and securities with limited marketability is estimated by Alberta Finance or external managers appointed by Alberta Finance using methods such as cost, discounted cash flows, earnings multiples, prevailing market values for instruments with similar characteristics and other pricing models as appropriate and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers using methods such as replacement cost, discounted cash flows, earnings multiples, prevailing market values for properties with similar characteristics and other pricing models as appropriate.

The fair values of deposits, receivables, accrued investment income and payables are estimated to approximate their book values.

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

SPECIAL FORCES PENSION PLAN

**Note 2 (continued)**

**(d) Foreign Exchange**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

**(e) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(f) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's actuarial value of accrued benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

While best estimates have been used in the calculation of the Plan's actuarial value of accrued benefits, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are disclosed as net experience gains or losses in the statement of changes in accrued benefits.

SPECIAL FORCES PENSION PLAN

## NOTE 3 INVESTMENTS (SCHEDULES A TO E)

*(thousands)*

| | 2004 Fair Value | % | 2003 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 8,803 | 0.8 | $ 6,713 | 0.6 |
| Canadian Dollar Public Bond Pool (b) | 346,426 | 30.0 | 307,380 | 29.0 |
| Private Mortgage Pool (c) | 59,298 | 5.1 | 54,733 | 5.2 |
| Total fixed income securities | 414,527 | 35.9 | 368,826 | 34.8 |
| **Canadian Equities (Schedule B)** | | | | |
| External Managers | | | | |
| Canadian Large Cap Equity Pool (d) | 95,328 | 8.3 | 93,139 | 8.8 |
| Canadian Small Cap Equity Pool (d) | 31,572 | 2.7 | 27,406 | 2.6 |
| Domestic Passive Equity Pooled Fund (e) | 76,780 | 6.6 | 74,959 | 7.1 |
| Canadian Pooled Equities Fund (f) | 32,354 | 2.8 | 27,472 | 2.6 |
| Private Equity Pool (g) | 1,301 | 0.1 | 1,621 | 0.2 |
| | 237,335 | 20.5 | 224,597 | 21.3 |
| **United States Equities (Schedule C)** | | | | |
| US Passive Equity Pooled Fund (h) | 113,279 | 9.8 | 109,491 | 10.3 |
| External Managers | | | | |
| US Large Cap Equity Pool (i) | 52,950 | 4.6 | 45,624 | 4.3 |
| US Mid/Small Cap Equity Pool (i) | 33,140 | 2.9 | 30,955 | 2.9 |
| S&P 500 Pooled Index Fund (h) | 11,465 | 1.0 | 10,769 | 1.0 |
| | 210,834 | 18.3 | 196,839 | 18.5 |
| **Non-North American Equities (Schedule D)** | | | | |
| External Managers | | | | |
| EAFE Core Equity Pool (j) | 119,758 | 10.4 | 112,978 | 10.7 |
| EAFE Plus Equity Pool (j) | 54,465 | 4.7 | 47,819 | 4.5 |
| EAFE Passive Equity Pool (k) | 687 | 0.1 | 15,217 | 1.4 |
| Emerging Markets Equity Pool (l) | 12,370 | 1.1 | - | - |
| EAFE Structured Equity Pooled Fund (k) | 44,646 | 3.9 | 40,225 | 3.8 |
| | 231,926 | 20.2 | 216,239 | 20.4 |
| **Alternative Investments - Equities** | | | | |
| Private Income Pool (m) | 3,875 | 0.3 | 493 | - |
| **Real Estate Equities (Schedule E)** | | | | |
| Private Real Estate Pool (n) | 55,793 | 4.8 | 52,613 | 5.0 |
| Total equities | 739,763 | 64.1 | 690,781 | 65.2 |
| **Total investments** | $ 1,154,290 | 100.0 | $ 1,059,607 | 100.0 |

SPECIAL FORCES PENSION PLAN

**NOTE 3 (continued)**

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) The Private Mortgage Pool is managed with the objective of providing investment returns higher than the Scotia Capital Universe Bond Index over the long term. The portfolio is comprised primarily of high-quality commercial mortgage loans and provincial bond residuals. In order to reduce risk, the pool only invests in loans insured by a federal agency and first-mortgage loans that provide diversification by property usage and geographic location.

(d) The External Managers Canadian Large Cap and Small Cap Equity Pools consist of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap or small cap equity markets. The Small Cap Pool is restricted to investing in publicly traded Canadian equities with a market capitalization of up to 0.15% of the Toronto Stock Exchange S&P/TSX Composite Index total market capitalization at time of purchase. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

(e) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

(f) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index over a four-year period while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection and sector rotation.

(g) The Private Equity Pool is in the process of orderly liquidation.

(h) The US Passive Equity Pooled Fund and the S&P 500 Pooled Index Fund are passively managed. The portfolios are comprised of publicly traded United States equities similar in weights to the Standard & Poor's S&P 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index over a four-year period. The pools utilize a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pools also invest in futures, swaps and other structured investments.

(i) The External Managers US Large Cap Equity Pool consists of multiple portfolios and the External Managers US Mid/Small Cap Equity Pool consists of a single portfolio of publicly traded United States equities. Each portfolio is actively managed by an external manager with expertise in the US large cap or mid/small cap equity markets. The performance objective is to provide returns higher than the total return of the S&P 500 Index for the US Large Cap Pool and the Russell 2500 Index for the US Mid/Small Cap Pool over a four-year period while reducing return volatility through multiple manager investment style and unique market capitalization focus.

(j) The External Managers EAFE (Europe, Australasia and Far East) Core and Plus Equity Pools consist of multiple portfolios of publicly traded Non-North American equities. Each core portfolio is actively managed by an external manager and has constraints on foreign currency management and deviations from the Morgan Stanley Capital International (MSCI) EAFE Index asset mix by country. The Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the MSCI EAFE Index over a four-year period while reducing return volatility through multiple manager investment style and market diversification.

SPECIAL FORCES PENSION PLAN

**NOTE 3 (continued)**

(k) The performance objective of the External Managers EAFE Passive Equity Pool and the EAFE Structured Equity Pooled Fund is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The External Managers EAFE Passive Equity Pool consists of a single portfolio of Non-North American publicly traded equities similar in weights to the MSCI EAFE index. The EAFE Structured Equity Pooled Fund is internally managed and provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

(l) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) Emerging Markets Free (EMF) Index over a four-year period.

(m) The Private Income Pool is managed with the objective of providing investment return comparable to the Consumer Price Index plus 6% over the long term. The pool invests in infrastructure related projects that are structured to yield high current income.

(n) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Investment Property Databank (IPD) Large Institutional All Property Index over the long term. Real estate is held through intermediary companies, which have issued to the pool common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. The pool is intended to provide diversification from the securities market.

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Plan are primarily affected by the long-term real rate of return expected to be earned on investments. The expected rate of return on investments, together with the expected long term inflation rate, form the basis for determining the economic assumptions used in calculating the actuarial liabilities. In order to earn the best possible return at an acceptable level of risk, the Board has established a benchmark policy asset mix of 37% fixed income instruments and 63% equities. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

SPECIAL FORCES PENSION PLAN

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Plan's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at December 31, 2004:

| *(thousands)* | Maturity | | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Net Fair Value (a) | Notional Amount | Net Fair Value (a) |
| | | % | | | | | |
| Equity index swap contracts | 78 | 22 | - | $ 204,961 | $ 8,294 | $ 196,640 | $ 8,306 |
| Cross-currency interest rate swap contracts | 27 | 28 | 45 | 84,880 | (4,913) | 75,614 | (8,141) |
| Interest rate swap contracts | 40 | 55 | 5 | 82,567 | (3,325) | 88,701 | (4,559) |
| Forward foreign exchange contracts | 100 | - | - | 27,781 | 111 | 8,526 | (6) |
| Credit default swap contracts | 18 | 20 | 62 | 22,967 | 95 | 3,380 | (41) |
| Bond index swap contracts | 100 | - | - | 6,753 | 131 | 4,951 | 7 |
| Equity index futures contracts | 100 | - | - | 4,264 | 484 | 3,128 | 379 |
| | | | | $ 434,173 | $ 877 | $ 380,940 | $ (4,055) |

(a) The method of determining fair value of derivative contracts is described in Note 2 (e).

SPECIAL FORCES PENSION PLAN

**NOTE 5 (continued)**

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

## NOTE 6 ACCOUNTS RECEIVABLE

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Contributions receivable | | |
| Employers | $ 1,086 | $ 1,063 |
| Employees | 1,001 | 983 |
| Province of Alberta | 202 | 185 |
| | 2,289 | 2,231 |
| Receivable from Alberta Pensions Administration Corporation | 90 | 169 |
| | $ 2,379 | $ 2,400 |

## NOTE 7 ACCRUED BENEFITS

**(a) Actuarial Valuation**

An actuarial valuation of the Plan was carried out as at December 31, 2001 by Hewitt and Associates and was then extrapolated to December 31, 2004.

Actuarial valuations were determined using the projected benefit method prorated on service. The assumptions used in the valuations and extrapolations were developed as the best estimate of expected short-term and long-term market conditions and other future events. After consultation with the Plan's actuary, the Board approved these best estimates.

The major assumptions used were:

| | December 31 | |
|---|---|---|
| | 2004 and 2003 Extrapolation % | 2001 Valuation % |
| Investment return | 7.0 | 7.0 |
| Inflation rate | 3.25 | 3.25 |
| Salary escalation rate* | 3.75 | 3.75 |
| Pension cost-of-living increase as a percent of Alberta Consumer Price Index | 60 | 60 |

* In addition to merit and promotion.

SPECIAL FORCES PENSION PLAN

**Note 7 (continued)**

In accordance with the requirements of the *Public Sector Pension Plans Act*, a separate accounting is required of the pension liability with respect to service that was recognized as pensionable as at December 31, 1991. This information is provided in the Statement of Changes in Accrued Benefits, which shows the principal components of the change in the actuarial value of accrued benefits.

Based on the information provided above, the following table summarizes the fair value of net assets, accrued benefits, and the resulting deficiency of the Plan Fund as at December 31, 2004:

*(thousands)*

| | Pre-1992 | Post-1991 | 2004 Total | 2003 Total |
|---|---|---|---|---|
| Plan Fund net assets available for benefits | $ 662,495 | $ 476,101 | $ 1,138,596 | $ 1,048,160 |
| Plan Fund accrued benefits | 812,850 | 534,099 | 1,346,949 | 1,275,387 |
| **Plan Fund Deficiency (Notes 12 and 13)** | $ (150,355) | $ (57,998) | $ (208,353) | $ (227,227) |

As at December 31, 2004, the Indexing Fund held investments of $18,056,000 (2003 $13,672,000) with offsetting accrued benefits of the same amount.

An actuarial valuation of the Plan as at December 31, 2004 will be carried out subsequent to the completion of these financial statements as required by the *Public Sector Pension Plans Act*. Any differences between the actuarial valuation results and the extrapolation results as reported in these financial statements, including the impact of changes to the maximum pensionable salary limit as announced in the 2005 Federal Budget estimated to amount to less than $1 million, will affect the financial position of the Plan and will be accounted for as gains or losses in 2005.

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation and extrapolation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

SPECIAL FORCES PENSION PLAN

**NOTE 7 (continued)**

The following is a summary of the sensitivities of the Plan's deficiency and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2004:

| | | Sensitivities | |
|---|---|---|---|
| | **Changes in Assumptions %** | **Increase in Plan Deficiency ($ million)** | **Increase in Current Service Cost as a % of Pensionable Earnings *** |
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 79 | 0.0% ** |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 30 | 1.0% |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant | (1.0%) | 188 | 2.8% |

* The current service cost as a % of pensionable earnings as determined by the December 31, 2001 valuation was 17.2%.

** Contributions to the Indexing Fund are fixed and are not affected by assumed inflation.

## NOTE 8 CONTRIBUTIONS

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Current and optional service | | |
| Employers | $ 19,594 | $ 18,387 |
| Employees | 18,089 | 17,051 |
| Unfunded liability | | |
| Employers | 2,392 | 2,226 |
| Employees | 2,392 | 2,226 |
| Province of Alberta | 2,471 | 2,300 |
| Transfers from other plans | 621 | 19 |
| | $ 45,559 | $ 42,209 |

SPECIAL FORCES PENSION PLAN

## NOTE 9 NET INVESTMENT INCOME

*(thousands)*

| Net investment income is comprised of the following: | 2004 | 2003 |
|---|---|---|
| Net realized and unrealized gains on investments, including those arising from derivative transactions | $ 59,387 | $ 84,882 |
| Interest income | 30,446 | 26,590 |
| Dividend income | 9,274 | 8,547 |
| Real estate income | 2,915 | 2,852 |
| Securities lending income | 260 | 272 |
| Pooled funds management and associated custodial fees | (1,683) | (1,162) |
| | $ 100,599 | $ 121,981 |

The following is a summary of the Plan's proportionate share of net investment income by type of investments:

| | 2004 | 2003 |
|---|---|---|
| Fixed Income Securities | $ 30,397 | $ 24,808 |
| Canadian Equities | 31,970 | 47,613 |
| Foreign Equities | | |
| United States | 7,322 | 15,761 |
| Non-North American | 25,309 | 28,778 |
| Alternative Investments - Equities | 5,483 | 107 |
| Real Estate Equities | 118 | 4,914 |
| | $ 100,599 | $ 121,981 |

The following is a summary of the investment performance results attained by the Plan:

| | One Year Return | Four-Year Compound Annualized Return | Eight -Year Compound Annualized Return |
|---|---|---|---|
| **Time-weighted rates of return*** | | | |
| Overall Plan | 9.5% | 3.2% | 7.1% |
| Policy Benchmark** | 9.2% | 2.5% | 6.8% |

* The measure involves the calculation of the net return realized by the Plan over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains and losses (realized and unrealized).

** The policy benchmark return is a product of the weighted average policy sector weights and sector returns.

SPECIAL FORCES PENSION PLAN

## NOTE 10 ADMINISTRATION EXPENSES

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| General administration costs | $ 1,009 | $ 951 |
| Investment management costs | 220 | 221 |
| Actuarial fees | 97 | 24 |
| | $ 1,326 | $ 1,196 |

Total administration expenses amounted to $283 per member (2003 $267 per member).

General administration costs including plan board costs were paid to Alberta Pensions Administration Corporation on a cost-recovery basis.

Investment management costs were paid to Alberta Finance and do not include pooled funds management and associated custodial fees, which have been included in the calculation of net investment income (see Note 9).

## NOTE 11 REMUNERATION OF BOARD MEMBERS

Remuneration paid to or on behalf of Board members, as approved by the Lieutenant Governor in Council, is as follows:

| | Chairman | Members |
|---|---|---|
| Remuneration rates effective March 1, 2004: | | |
| Up to 4 hours | $ 165 | $ 122 |
| 4 to 8 hours | 280 | 203 |
| Over 8 hours | 447 | 318 |

| | 2004 | 2003 |
|---|---|---|
| During 2004, the following amounts were paid: | | |
| Remuneration | | |
| Chair | $ 7,640 | $ 3,536 |
| Members (5)* | 28,206 | 14,962 |
| Travel expenses | | |
| Chair | 9,510 | 673 |
| Members (5) | 28,109 | 17,216 |

* Crown representative nominated by the Government of Alberta receives no remuneration.

SPECIAL FORCES PENSION PLAN

## NOTE 12 FUNDING VALUATION AND EXTRAPOLATION

The Plan's deficiency is determined on the fair value basis for accounting purposes. For funding valuation and extrapolation purposes, asset values are adjusted for fluctuations in fair values to moderate the effect of market volatility on the Plan's funded status. Actuarial asset values for funding valuation and extrapolation purposes amounted to $1,109 million at December 31, 2004 (2003 $1,049 million).

In accordance with the *Public Sector Pension Plans Act*, the unfunded liability for post-1991 service as determined by an actuarial funding valuation at December 31, 2001 is financed by a special payment of 0.92% of pensionable salary shared equally between employees and employers effective January 1, 2003 and continuing 15 years from the date of valuation until December 31, 2016. The special payment is included in the rates in effect at December 31, 2004 (see Note 1(b)).

## NOTE 13 CHANGE IN ACCOUNTING POLICY

In order to eliminate any misunderstanding about the actual financial position of the Plan, in 2004, the Board introduced a change in accounting policy and assets are now valued on the fair value basis for accounting purposes with no smoothed value reported.

As at December 31, 2004, this change in accounting policy has the effect of decreasing the Plan's deficiency by $48 million. If the change had not been made, the Plan's deficiency would have been $256 million as at December 31, 2004.

This change in accounting policy has been applied retroactively and the Plan's deficiencies at December 31, 2002 and 2003 have been restated. The effect of this change in accounting policy is to increase retroactively the Plan's deficiency by $61 million at December 31, 2002 and decrease retroactively the Plan's deficiency by $13 million at December 31, 2003.

## NOTE 14 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2004 presentation.

## NOTE 15 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were prepared by management and approved by the Board.

SPECIAL FORCES PENSION PLAN

# SCHEDULES TO THE SPECIAL FORCES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

Year Ended December 31, 2004 *(thousands)*

| | Plan's share 2004 | Plan's share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 10,939 | $ 8,397 |
| **Fixed income securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 96,516 | 78,051 |
| Provincial | | |
| Alberta, direct and guaranteed | 219 | 235 |
| Other, direct and guaranteed | 83,774 | 49,464 |
| Municipal | 4,541 | 4,713 |
| Corporate | 129,237 | 142,716 |
| Private | | |
| Corporate | 87,899 | 85,019 |
| | 402,186 | 360,198 |
| Receivable from sale of investments and accrued investment income | 4,229 | 3,994 |
| Liabilities for investment purchases | (2,827) | (3,763) |
| | 1,402 | 231 |
| | $ 414,527 | $ 368,826 |

(a) Fixed income securities held as at December 31, 2004 had an average effective market yield of 4.44% per annum (2003 4.79% per annum). The following term structure of these securities as at December 31, 2004 was based on principal amount.

| | 2004 | 2003 |
|---|---|---|
| | % | |
| under 1 year | 3 | 3 |
| 1 to 5 years | 36 | 38 |
| 6 to 10 years | 32 | 30 |
| 11 to 20 years | 13 | 9 |
| over 20 years | 16 | 20 |
| | 100 | 100 |

SPECIAL FORCES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES — Schedule B

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 2,296 | $ 2,274 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 19,398 | 18,656 |
| Consumer staples | 11,980 | 10,977 |
| Energy | 41,215 | 31,628 |
| Financials | 68,523 | 62,762 |
| Health care | 4,696 | 5,725 |
| Industrials | 20,459 | 23,894 |
| Information technology | 13,759 | 12,670 |
| Materials | 39,931 | 36,550 |
| Telecommunication services | 9,679 | 10,096 |
| Utilities | 1,452 | 5,007 |
| | 231,092 | 217,965 |
| Passive index | 505 | 375 |
| | 231,597 | 218,340 |
| **Private Equity Pool** | 1,301 | 1,621 |
| Receivable from sale of investments and accrued investment income | 2,293 | 2,751 |
| Liabilities for investment purchases | (152) | (389) |
| | 2,141 | 2,362 |
| | $ 237,335 | $ 224,597 |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $54,603,000 (2003 $48,985,000) which were used as underlying securities to support the notional amount of Canadian equity index swap contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

SPECIAL FORCES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES — Schedule C

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 6,246 | $ 8,279 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 30,407 | 28,571 |
| Consumer staples | 16,964 | 17,595 |
| Energy | 14,566 | 10,720 |
| Financials | 40,759 | 39,026 |
| Health care | 25,494 | 24,040 |
| Industrials | 26,699 | 21,403 |
| Information technology | 29,933 | 32,119 |
| Materials | 8,385 | 6,364 |
| Telecommunication services | 5,373 | 5,466 |
| Utilities | 6,008 | 5,368 |
| | 204,588 | 190,672 |
| Passive index | - | 84 |
| | 204,588 | 190,756 |
| Receivable from sale of investments and accrued investment income | 1,476 | 1,412 |
| Liabilities for investment purchases | (1,476) | (3,608) |
| | - | (2,196) |
| | $ 210,834 | $ 196,839 |

(a) The Plan's net investment in United States public equities includes the fair value of deposits and floating rate notes, totalling $112,473,000 (2003 $107,477,000), which were used as underlying securities to support the notional amount of US equity index swap contracts and futures contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard and Poor's S&P 500 Index.

SPECIAL FORCES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 4,084 | $ 3,671 |
| **Public equities (a) (b)** | | |
| Consumer discretionary | 31,361 | 31,840 |
| Consumer staples | 13,109 | 16,661 |
| Energy | 19,091 | 15,699 |
| Financials | 61,455 | 51,669 |
| Health care | 13,733 | 16,881 |
| Industrials | 24,650 | 22,761 |
| Information technology | 10,966 | 12,661 |
| Materials | 17,920 | 15,811 |
| Telecommunication services | 19,340 | 18,872 |
| Utilities | 9,020 | 8,306 |
| | 220,645 | 211,161 |
| Passive index | 5,201 | 28 |
| Receivable from sale of investments and accrued investment income | 2,930 | 2,169 |
| Liabilities for investment purchases | (934) | (790) |
| | 1,996 | 1,379 |
| | $ 231,926 | $ 216,239 |

(a) The Plan's net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $42,149,000 (2003 $38,632,000), which were used as underlying securities to support the notional amount of Non-North American equity index swaps contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard and Poor's. The following is a summary of the Plan's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased:

| *(thousands)* | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| United Kingdom | $ 49,615 | $ 49,923 |
| Japan | 39,699 | 36,166 |
| France | 20,099 | 21,208 |
| Germany | 15,364 | 15,285 |
| Switzerland | 14,898 | 16,897 |
| Netherlands | 12,220 | 12,008 |
| Australia | 10,392 | 11,095 |
| Italy | 9,174 | 9,214 |
| Sweden | 5,775 | 4,189 |
| Spain | 5,720 | 5,953 |
| Other | 37,689 | 29,223 |
| | $ 220,645 | $ 211,161 |

SPECIAL FORCES PENSION PLAN

## SCHEDULE OF INVESTMENTS IN REAL ESTATE

**Schedule E**

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 6 | $ 43 |
| **Real estate (a)** | | |
| Office | 27,886 | 23,331 |
| Retail | 20,026 | 22,087 |
| Industrial | 4,398 | 3,567 |
| Residential | 2,703 | 3,089 |
| | 55,013 | 52,074 |
| Passive index | 695 | 362 |
| Receivable from sale of investments and accrued investment income | 79 | 134 |
| | $ 55,793 | $ 52,613 |

(a) The following is a summary of the Plan's investment in real estate by geographic locations:

*(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| Ontario | $ 35,663 | $ 38,058 |
| Alberta | 12,196 | 12,948 |
| Quebec | 6,196 | - |
| British Columbia | 958 | 1,068 |
| | $ 55,013 | $ 52,074 |

# SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## Financial Statements

YEAR ENDED DECEMBER 31, 2004

# AUDITOR'S REPORT

**To the Minister of Finance**

I have audited the Statement of Net Assets Available for Benefits of the Supplementary Retirement Plan for Public Service Managers (the Plan) as at December 31, 2004 and the Statement of Changes in Net Assets Available for Benefits for the year then ended. These financial statements are the responsibility of the Plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the Net Assets Available for Benefits of the Plan as at December 31, 2004 and the Changes in Net Assets Available for Benefits for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Edmonton, Alberta
April 29, 2005

Fred J. Dunn, FCA
Auditor General

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS

As at December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Net Assets Available for Benefits** | | |
| Assets | | |
| Portfolio investments (Note 3) | $ 4,196 | $ 2,813 |
| Refundable income tax | 5,405 | 3,707 |
| Contributions receivable | 15 | 4 |
| | 9,616 | 6,524 |
| Liabilities | | |
| Actuarial value of accrued benefits (Note 6) | 19,434 | 14,161 |
| Income tax payable | 193 | 190 |
| Other payables | 101 | 87 |
| | 19,728 | 14,438 |
| Excess of liabilities over assets | (10,112) | (7,914) |
| SRP Reserve Fund (Note 7) | 19,516 | 17,226 |
| **Net assets available for benefits** | $ 9,404 | $ 9,312 |

## STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the Year Ended December 31, 2004 *(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Increase in assets** | | |
| Contributions | | |
| Employees | $ 1,643 | $ 1,376 |
| Employers | 1,643 | 1,376 |
| Net investment income (Note 8) | 263 | 64 |
| | 3,549 | 2,816 |
| **Decrease in assets** | | |
| Increase in actuarial value of accrued benefits | (5,273) | (3,878) |
| Benefits and refunds | (79) | (44) |
| Administration expenses (Note 9) | (395) | (368) |
| | (5,747) | (4,290) |
| Increase in the SRP Reserve Fund (Note 7) | 2,290 | 4,314 |
| **Increase in net assets** | 92 | 2,840 |
| **Net assets available for benefits at beginning of year** | 9,312 | 6,472 |
| **Net assets available for benefits at end of year** | $ 9,404 | $ 9,312 |

*The accompanying notes are part of these financial statements.*

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

# NOTES TO THE FINANCIAL STATEMENTS

December 31, 2004

## NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Supplementary Retirement Plan for Public Service Managers (the Plan) is a summary only. For a complete description of the Plan, reference should be made to sections 5, 7 and 98 of the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 and the Retirement Compensation Arrangement Directive (Treasury Board Directive 01/99 and 04/99), as amended.

**(a) General**

The Plan was established on July 1, 1999 to provide additional pension benefits to certain public service managers of designated employers who participate in the Management Employees Pension Plan (MEPP) and whose annual salary exceeds the yearly maximum pensionable earnings limit as defined by the federal *Income Tax Act.* The Plan is supplementary to the MEPP. Services under MEPP are used to determine eligibility for vesting and early retirement. A member's pension commencement date is the same under both Plans and the pension is payable in the same form. Members of MEPP who have attained 35 years of combined pensionable service at the Plan's inception are not eligible to participate in the Plan.

**(b) Funding Policy**

Current service costs are funded by employee and employer contributions which together with investment earnings and transfers from the SRP Reserve Fund (see Note 7) are expected to provide for all benefits payable under the Plan. The contribution rate for designated employers equals or exceeds the rate for eligible employees. The contribution rates in effect at December 31, 2004 were unchanged at 9.5% of pensionable salary in excess of the *yearly* maximum pensionable earnings limit for eligible employees and designated employers. An actuarial valuation of the Plan is required to be performed at least once every three years. The rates are to be reviewed periodically by the Minister of Finance.

**(c) Benefits**

The Plan provides a pension of 2.0% of pensionable earnings that are in excess of the *Income Tax Act's* yearly maximum pensionable earnings limit for each year of pensionable service after July 1, 1999, based on the average salary of the highest five consecutive years.

Members are entitled to an unreduced pension on service if they retire with at least five years of combined pensionable service and have either attained age 60, or age 55 and the sum of their age and combined pensionable service equals 80. Pensions are reduced if the member is under age 60 and the 80 factor is not attained.

Disability, death, termination benefits and cost-of-living adjustments under this Plan follow those of the MEPP.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 1 (continued)**

**(d) Guarantee**

Designated employers guarantee payment of all benefits arising under the Plan. If assets held in the Plan are insufficient to pay for benefits as they become due, the amount due is payable by designated employers.

**(e) Surplus Plan Assets**

The Government has the right to amend or discontinue the Plan in whole or in part at any time. Any assets remaining in the Plan after provision for benefits payable to or in respect of members on the complete wind-up of the Plan accrue to the Government.

**(f) Income Taxes**

The Plan is a Retirement Compensation Arrangement (RCA) as defined in the *Income Tax Act*. Refundable income tax is remitted on investment earnings and any cash contributions from eligible employees and designated employers at the rate of 50%. Refundable income tax is returned to the Plan at the same rate when pension benefits payments are made to plan members and beneficiaries.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist plan members and others in reviewing the activities of the Plan for the year.

Plan investments are held in pooled investment funds administered by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

**(b) Valuation of Assets and Liabilities**

Investments are stated at fair value. The methods used to determine the fair value of investments held by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Due to uncertainties about the timing of benefits and refunds payments, it is not practicable to estimate the fair value of refundable income tax. Refundable income tax is carried at cost.

The fair values of deposits, other receivables, accrued investment income and payables are estimated to approximate their book values.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 2 (continued)**

**(c) Income Recognition**

Dividends are accrued on the ex-dividend date. Investment income is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

**(d) Valuation of Derivative Contracts**

Derivative contracts (see Note 5) include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts, credit default swaps and cross-currency interest rate swaps. The value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

**(e) Measurement Uncertainty**

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the calculation of the Plan's actuarial value of accrued benefits. Uncertainty arises because the Plan's actual experience may differ, perhaps significantly, from assumptions used in the calculation.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 2 (continued)**

While best estimates have been used in the calculation, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are disclosed as assumption or other changes and net experience gains or losses in the note describing changes in the actuarial value of accrued benefits (see Note 6(a)).

## NOTE 3 PORTFOLIO INVESTMENTS

| | 2004 Fair Value | % | 2003 Fair Value | % |
|---|---|---|---|---|
| **Fixed Income Securities (Schedule A)** | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 1,644 | 39.2 | $ 2,813 | 100.0 |
| Canadian Dollar Public Bond Pool (b) | 1,509 | 36.0 | - | - |
| Total fixed income securities | 3,153 | 75.2 | 2,813 | 100.0 |
| **Equities (Schedule B)** | | | | |
| **Canadian Equities** | | | | |
| Canadian Pooled Equities Fund (c) | 808 | 19.2 | - | - |
| Growing Equity Income Pool (d) | 214 | 5.1 | - | - |
| | 1,022 | 24.3 | - | - |
| **United States Equities** | | | | |
| Growing Equity Income Pool (d) | 21 | 0.5 | - | - |
| Total equities | 1,043 | 24.8 | - | - |
| **Total investments** | $ 4,196 | 100.0 | $ 2,813 | 100.0 |

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years.

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.

(c) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index over a four-year period while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection and sector rotation.

(d) The Growing Equity Income Pool is managed with the objective of providing returns higher than the return of S&P/TSX Custom Dividend Index over a four-year period. The Pool is intended to provide a steady stream of dividend income with potential for capital appreciation by investing in dividend-paying Canadian and US companies that exhibit attractive valuation, growth and quality financial characteristics.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

Actuarial liabilities of the Plan are primarily affected by the long term real rate of return expected to be earned on investments. The expected rate of return on investments, together with the expected long term inflation rate form the basis for determining the economic assumptions used in calculating the actuarial liabilities. In order to earn the best possible return at an acceptable level of risk, the Minister has established a benchmark policy asset mix of 45% fixed income instruments and 55% equities. Investment risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 5).

## NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Plan uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity.

Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 5 (continued)**

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Plan's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at December 31, 2004:

| *(thousands)* | Maturity | | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Net Fair Value (a) | Notional Amount | Net Fair Value (a) |
| | | % | | | | | |
| Cross-currency interest rate swap contracts | 10 | 9 | 81 | $ 132 | $ (11) | $ - | $ - |
| Forward foreign exchange contracts | 100 | - | - | 31 | 1 | - | - |
| Bond index swap contracts | 100 | - | - | 29 | 1 | - | - |
| Equity index futures contracts | 100 | - | - | 18 | 1 | - | - |
| Credit default swap contracts | - | - | 100 | 9 | - | - | - |
| Interest rate swap contracts | 100 | - | - | 4 | - | - | - |
| | | | | $ 223 | $ (8) | $ - | $ - |

(a) The method of determining fair value of derivative contracts is described in Note 2 (d).

The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Plan attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

## NOTE 6 ACTUARIAL VALUE OF ACCRUED BENEFITS

### (a) Actuarial Valuation

An actuarial valuation of the Plan was carried out as at December 31, 2002 by Aon Consulting Inc. and was then extrapolated to December 31, 2004. Actuarial valuations were determined using the projected benefit method prorated on service. The assumptions used in the valuation were developed as the best estimate of expected short-term and long-term market conditions and other future events. After consultation with the Plan's actuary, the Plan's management approved this best estimate.

## SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 6 (continued)**

The major assumptions used were:

| | 2003 and 2004 Extrapolation % | 2002 Valuation % |
|---|---|---|
| Discount rate * | 4.50 | 4.50 |
| Inflation rate | 3.00 | 3.00 |
| Investment rate of return | 6.00 | 6.00 |
| Salary escalation rate ** | 3.50 | 3.50 |
| Pension cost-of-living increase as a percentage of Alberta Consumer Price Index | 60.0 | 60.0 |

* Discount rate is on an after-tax basis.

** In addition to merit and promotion which averages 1.5%.

The following table shows the principal components of the change in the actuarial value of accrued benefits:

*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| **Actuarial value of accrued benefits at beginning of year** | $ 14,161 | $ 10,283 |
| Interest accrued on benefits | 741 | 611 |
| Benefits earned | 4,707 | 3,311 |
| Impact of changes in the yearly maximum pension accruals limit | (96) | - |
| Benefits and refunds | (79) | (44) |
| **Actuarial value of accrued benefits at end of year** | $ 19,434 | $ 14,161 |

**(b) Sensitivity of Changes in Major Assumptions**

The Plan's future experience will inevitably differ, perhaps significantly, from the assumptions used in the actuarial valuation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

**NOTE 6 (continued)**

The following is a summary of the sensitivities of the Plan's net assets and current service cost to changes in assumptions used in the actuarial valuation at December 31, 2004:

| | Changes in Assumptions % | Sensitivities Decrease in Net Assets ($ millions) | Increase in Benefits Earned ($ millions) |
|---|---|---|---|
| Inflation rate increase holding nominal investment return and salary escalation assumptions constant | 1.0% | $ 1.5 | $ 0.3 |
| Salary escalation rate increase holding inflation rate and nominal investment return assumptions constant | 1.0% | 4.3 | 1.1 |
| Investment rate of return decrease holding inflation rate and salary escalation assumptions constant* | (1.0%) | 4.4 | 1.2 |

* Sensitivities includes investment return of assets held by the SRP Reserve Fund (Note 7).

## NOTE 7 SUPPLEMENTARY RETIREMENT PLAN RESERVE FUND (SRP RESERVE FUND)

Designated employers guarantee payment of all benefits arising under the Plan (see Note 1 (d)). To provide for their future obligations to the Plan, designated employers contribute to a Reserve Fund at rates established by the Minister of Finance. The rate in effect at December 31, 2004, as recommended by the Plan's actuary, was unchanged at 6.8% of pensionable salary of eligible employees that was in excess of the yearly maximum pensionable earnings limit as defined by the *Income Tax Act.* The actuary has advised that any impairment of the Plan's surplus assets will result in an increase in the 6.8% employer contribution rate to the Reserve Fund.

The Reserve Fund is a regulated fund established and administered by the Minister of Finance to collect contributions from designated employers and to invest the funds, which are reserved to meet future benefit payments of the Plan.

As at December 31, 2004, the Reserve Fund had net assets with fair value totalling $19,516,000 (2003 $17,226,000), comprising $19,427,000 (2003 $17,792,000) in portfolio investments and $89,000 in contributions receivable (2003 $566,000 in payables, net). The increase during the year of $2,290,000 (2003 $4,314,000) is attributed to contributions from employers of $1,162,000 (2003 $3,837,000) and investment income of $1,128,000 (2003 $477,000).

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## NOTE 8 NET INVESTMENT INCOME

Net investment income of the Plan is comprised of the following:
*(thousands)*

| | 2004 | 2003 |
|---|---|---|
| Net realized and unrealized gains on investments, including those arising from derivative transactions | $ 141 | $ - |
| Interest income | 105 | 64 |
| Dividend income | 18 | - |
| Pool funds management and associated custodial fees | (1) | - |
| | $ 263 | $ 64 |

The following is a summary of the Plan's proportionate share of net investment income by type of investments:

| | 2004 | 2003 |
|---|---|---|
| Fixed Income Securities | $ 130 | $ 64 |
| Equities | 133 | - |
| | $ 263 | $ 64 |

## NOTE 9 ADMINISTRATION EXPENSES

Administration expenses including investment management costs in the amount of $11,000 (2003 $nil) were charged to the Plan on a cost-recovery basis.

Administration expenses amounted to $373 (2003 $373) per member.

## NOTE 10 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2004 presentation.

## NOTE 11 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were approved by the Advisory Committee for the Supplementary Retirement Plan for Public Service Managers.

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

# SCHEDULES TO THE SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES — Schedule A

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 1,651 | $ 2,813 |
| **Fixed income securities (a)** | | |
| Public | | |
| Government of Canada, direct and guaranteed | 421 | - |
| Provincial | | |
| Alberta, direct and guaranteed | 1 | - |
| Other, direct and guaranteed | 352 | - |
| Municipal | 20 | - |
| Corporate | 562 | |
| Private | | |
| Corporate | 142 | - |
| | 1,498 | - |
| Receivable from sale of investments and accrued investment income | 16 | - |
| Liabilities for investment purchases | (12) | - |
| | 4 | - |
| | $ 3,153 | $ 2,813 |

(a) Fixed income securities held as at December 31, 2004 had an average effective market yield of 4.31% per annum (2003 2.38% per annum). The following term structure of these securities as at December 31, 2004 was based on principal amount:

| | 2004 % | 2003 % |
|---|---|---|
| under 1 year | 2 | 100 |
| 1 to 5 years | 39 | - |
| 6 to 10 years | 31 | - |
| 11 to 20 years | 13 | - |
| over 20 years | 15 | - |
| | 100 | 100 |

SUPPLEMENTARY RETIREMENT PLAN FOR PUBLIC SERVICE MANAGERS

## SCHEDULE OF INVESTMENTS IN EQUITIES

**Schedule B**

Year Ended December 31, 2004 *(thousands)*

| | Plan's Share 2004 | Plan's Share 2003 |
|---|---|---|
| **Deposits and short-term securities** | $ 3 | $ - |
| **Canadian public equities (a) (b)** | | |
| Consumer discretionary | 62 | - |
| Consumer staples | 48 | - |
| Energy | 198 | - |
| Financials | 345 | - |
| Health care | 16 | - |
| Industrials | 72 | - |
| Information technology | 53 | - |
| Materials | 155 | - |
| Telecommunication services | 52 | - |
| Utilities | 10 | - |
| | 1,011 | - |
| **United States public equities (b)** | | |
| Financials | 15 | - |
| Industrials | 6 | - |
| | 21 | |
| Receivable from sale of investments and accrued investment income | 8 | - |
| | $ 1,043 | $ - |

(a) The Plan's net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $18,000 (2003 $nil), which were used as underlying securities to support Canadian equity index futures contracts.

(b) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's.

2005

# ALPHABETICAL LIST OF ENTITIES' FINANCIAL STATEMENTS

# ALPHABETICAL LIST OF ENTITIES' FINANCIAL STATEMENTS

## ENTITIES INCLUDED IN THE CONSOLIDATED GOVERNMENT REPORTING ENTITY

| *Ministry, Department, Fund or Agency* | *Ministry Annual Report* |
|---|---|
| Agriculture Financial Services Corporation[1] | Agriculture, Food and Rural Development |
| Alberta Alcohol and Drug Abuse Commission | Health and Wellness |
| Alberta Capital Finance Authority | Finance |
| Alberta Energy and Utilities Board | Energy |
| Alberta Foundation for the Arts | Community Development |
| Alberta Gaming and Liquor Commission | Gaming |
| Alberta Government Telephones Commission | Finance |
| Alberta Heritage Foundation for Medical Research Endowment Fund | Finance |
| Alberta Heritage Savings Trust Fund | Finance |
| Alberta Heritage Scholarship Fund | Finance |
| Alberta Heritage Science and Engineering Research Endowment Fund | Finance |
| Alberta Historical Resources Foundation | Community Development |
| Alberta Insurance Council | Finance |
| Alberta Pensions Administration Corporation | Finance |
| Alberta Petroleum Marketing Commission | Energy |
| Alberta Research Council Inc. | Innovation and Science |
| Alberta Risk Management Fund | Finance |
| Alberta School Foundation Fund | Education |
| Alberta Science and Research Authority | Innovation and Science |
| Alberta Securities Commission | Finance |
| Alberta Social Housing Corporation | Seniors and Community Supports |
| Alberta Sport, Recreation, Parks and Wildlife Foundation | Community Development |
| Alberta Treasury Branches | Finance |
| ATB Investment Services Inc. | Finance |
| Child and Family Services Authorities: | Children's Services |
| Calgary and Area Child and Family Services Authority | |
| Central Alberta Child and Family Services Authority | |
| East Central Alberta Child and Family Services Authority | |
| Edmonton and Area Child and Family Services Authority | |
| North Central Alberta Child and Family Services Authority | |
| Northeast Alberta Child and Family Services Authority | |
| Northwest Alberta Child and Family Services Authority | |
| Southeast Alberta Child and Family Services Authority | |
| Southwest Alberta Child and Family Services Authority | |
| Metis Settlements Child and Family Services Authority | |
| Credit Union Deposit Guarantee Corporation | Finance |
| Crop Reinsurance Fund of Alberta[1] | Agriculture, Food and Rural Development |
| Department of Agriculture, Food and Rural Development | Agriculture, Food and Rural Development |
| Department of Children's Services | Children's Services |
| Department of Community Development | Community Development |
| Department of Education | Education |
| Department of Energy | Energy |
| Department of Finance | Finance |
| Department of Gaming | Gaming |
| Department of Health and Wellness | Health and Wellness |
| Department of Innovation and Science | Innovation and Science |
| Department of Seniors and Community Supports | Seniors and Community Supports |
| Department of Solicitor General | Solicitor General |

1 The Crop Reinsurance Fund of Alberta was merged into the Agriculture Financial Services Corporation, effective April 1, 2003.

## ENTITIES INCLUDED IN THE CONSOLIDATED GOVERNMENT REPORTING ENTITY

| *Ministry, Department, Fund or Agency* | *Ministry Annual Report* |
|---|---|
| Department of Sustainable Resource Development | Sustainable Resource Development |
| Environmental Protection and Enhancement Fund | Sustainable Resource Development |
| Gainers Inc. | Finance |
| Government House Foundation | Community Development |
| Historic Resources Fund | Community Development |
| Human Rights, Citizenship and Multiculturalism Education Fund | Community Development |
| iCORE Inc. | Innovation and Science |
| Lottery Fund | Gaming |
| Ministry of Advanced Education[2] | Advanced Education |
| Ministry of Aboriginal Affairs and Northern Development[2] | Aboriginal Affairs and Northern Development |
| Ministry of Agriculture, Food and Rural Development | Agriculture, Food and Rural Development |
| Ministry of Children's Services | Children's Services |
| Ministry of Community Development | Community Development |
| Ministry of Economic Development[2] | Economic Development |
| Ministry of Education | Education |
| Ministry of Energy | Energy |
| Ministry of Environment[2] | Environment |
| Ministry of Finance | Finance |
| Ministry of Executive Council[2] | Executive Council |
| Ministry of Gaming | Gaming |
| Ministry of Government Services[2] | Government Services |
| Ministry of Health and Wellness | Health and Wellness |
| Ministry of Human Resources and Employment[2] | Human Resources and Employment |
| Ministry of Infrastructure and Transportation[2] | Infrastructure and Transportation |
| Ministry of Innovation and Science | Innovation and Science |
| Ministry of International and Intergovernmental Relations[2] | International and Intergovernmental Relations |
| Ministry of Justice[2] | Justice |
| Ministry of Municipal Affairs[2] | Municipal Affairs |
| Ministry of Restructuring and Government Efficiency[2] | Restructuring and Government Efficiency |
| Ministry of Seniors and Community Supports | Seniors and Community Supports |
| Ministry of Solicitor General | Solicitor General |
| Ministry of Sustainable Resource Development | Sustainable Resource Development |
| N.A. Properties (1994) Ltd. | Finance |
| Natural Resources Conservation Board | Sustainable Resource Development |
| Persons with Developmental Disabilities Community Boards: | Seniors and Community Supports |
| Calgary Region Community Board | |
| Central Region Community Board | |
| Edmonton Region Community Board | |
| Northeast Region Community Board | |
| Northwest Region Community Board | |
| South Region Community Board | |
| Persons with Developmental Disabilities Provincial Board | Seniors and Community Supports |
| Provincial Judges and Masters in Chambers Reserve Fund | Finance |
| Supplementary Retirement Plan Reserve Fund | Finance |
| Victims of Crime Fund | Solicitor General |
| Wild Rose Foundation | Community Development |

2 Ministry includes only the departments so separate department financial statements are not necessary.

## ENTITIES NOT INCLUDED IN THE CONSOLIDATED GOVERNMENT REPORTING ENTITY

| *Fund or Agency* | *Ministry Annual Report* |
|---|---|
| Alberta Cancer Board | Health and Wellness |
| Alberta Foundation for Health Research | Innovation and Science |
| Alberta Heritage Foundation for Medical Research | Innovation and Science |
| Alberta Heritage Foundation for Science and Engineering Research | Innovation and Science |
| Alberta Mental Health Board | Health and Wellness |
| Alberta Teachers' Retirement Fund Board | Education |
| Improvement Districts' Trust Account | Municipal Affairs |
| Local Authorities Pension Plan | Finance |
| Long-Term Disability Income Continuance Plan - Bargaining Unit | Human Resources and Employment |
| Long-Term Disability Income Continuance Plan - Management, Opted Out and Excluded | Human Resources and Employment |
| Management Employees Pension Plan | Finance |
| Provincial Judges and Masters in Chambers Pension Plan | Finance |
| Provincial Judges and Masters in Chambers (Unregistered) Pension Plan | Finance |
| Public Post Secondary Institutions | Advanced Education |
| Public Service Management (Closed Membership) Pension Plan | Finance |
| Public Service Pension Plan | Finance |
| Regional Health Authorities | Health and Wellness |
| School Boards | Education |
| Special Areas Trust Account | Municipal Affairs |
| Special Forces Pension Plan | Finance |
| Supplementary Retirement Plan for Public Service Managers | Finance |
| Workers' Compensation Board | Human Resources and Employment |