

AUDITORS' REPORT

To the Board of Directors
Public Sector Pension Investment Board –
Canadian Forces Pension Plan Account

We have audited the balance sheet and the statement of investment portfolio of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account (the “Canadian Forces Pension Plan Account”) as at March 31, 2001 and the statements of operations and accumulated net loss and of changes in net assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board’s (“PSP Investments”) 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 Canadian Forces Pension Plan Account and the investments held as at March 31, 2001 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Further, in our opinion, the transactions of the Canadian Forces Pension Plan Account that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with the *Public Sector Pension Investment Board Act* (the “Act”) and the by-laws.

Further, in our opinion, the record of investments kept by PSP Investments’ management pursuant to paragraph 35(1)(c) of the Act fairly presents, in all material respects, the information required by the Act.

Deloitte & Touche LLP

CHARTERED ACCOUNTANTS
Toronto, Ontario, April 27, 2001

THE CANADIAN FORCES PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31, 2001

	(\$000)
ASSETS	
Investments – at fair value (Note 2)	\$ 532,690
Cash	43
Accrued income	5
	532,738
LIABILITIES	
Accrued liabilities	22
Due to Public Service Pension Plan Account (Note 6)	270
	292
NET ASSETS	\$ 532,446
NET ASSETS REPRESENTED BY	
Accumulated net loss from operations	\$ (48,631)
Fund transfers (Note 3)	581,077
	\$ 532,446

On behalf of the Board of Directors:



PAUL CANTOR

Director and Chair of the Audit and Conflicts Committee

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31, 2001

	(\$000)
NET ASSETS, BEGINNING OF YEAR	\$ —
CHANGES IN NET ASSETS	
Fund transfers (Note 3)	581,077
Net loss from operations	(48,631)
INCREASE IN NET ASSETS AND NET ASSETS, END OF YEAR	\$ 532,446

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STATEMENT OF OPERATIONS AND ACCUMULATED NET LOSS

For the year ended March 31, 2001

	(\$000)
INVESTMENT ACTIVITIES	
Investment income	
Interest	\$ 678
Realized losses	(17)
Unrealized losses	(48,530)
	(47,869)
Investment expenses (Note 5)	53
	(47,922)
ADMINISTRATIVE ACTIVITIES (Note 6)	
Operating expenses	219
Salaries and benefits	167
Professional and consulting fees	323
	709
NET LOSS FROM OPERATIONS AND ACCUMULATED NET LOSS FROM OPERATIONS FOR THE YEAR	\$ (48,631)

STATEMENT OF INVESTMENT PORTFOLIO

As at March 31, 2001

	COST	FAIR VALUE	% OF PORTFOLIO (AT FAIR VALUE)
	(\$000)	(\$000)	
Canadian Equities			
SSgA* TSE 300 World Index Fund	\$ 221,110	\$ 180,831	33.9
U.S. Equities (Note 2)			
SSgA* U.S. World Index Fund	79,939	71,294	13.4
Non-North American Equities (Note 2)			
SSgA* EAFE Index Funds	79,102	70,567	13.3
Canadian Fixed Income			
SSgA* Canadian Fixed Income Index Fund	196,404	205,333	38.5
Cash Equivalents	4,665	4,665	0.9
	\$ 581,220	\$ 532,690	100.0%

*Investments are in pooled funds managed by State Street Global Advisors (SSgA).

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NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2001

ORGANIZATION

The Public Sector Pension Investment Board (“PSP Investments”) was formed pursuant to the *Public Sector Pension Investment Board Act* (the “Act”) with a mandate to invest in financial markets the contributions to the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans. Prior to the implementation of the provisions of the Act, the balances of the plans were credited with a rate of interest based on long-term Government of Canada bonds.

The Canadian Forces Pension Fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The excess of contributions over benefits is transferred, by the Canadian Forces Pension Fund, to PSP Investments – Canadian Forces Pension Plan Account for investment.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Canadian Forces Superannuation Act*. The amounts are to be invested with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the *Canadian Forces Superannuation Act*.

PSP Investments commenced operations April 1, 2000, and has a fiscal year end of March 31.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Basis of presentation*

These financial statements present the financial position and operations of PSP Investments as they pertain to the investment of the excess funds transferred to it from the Canadian Forces Pension Fund. Accordingly, they do not reflect all of the assets, nor the details of the pension contributions, payments and liabilities of the Canadian Forces Pension Plan. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Act.

Valuation of investments

Investments are recorded as of the trade date and are stated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act.

Fair value for investments in pooled funds is based on unit values, which reflect the quoted market prices of the underlying securities.

Income recognition

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, unrealized gains and losses on investments held at the end of the year, interest income and distributions from pooled funds.

Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized

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and unrealized gains and losses are included in investment income.

Fund transfers

Amounts received from the Canadian Forces Pension Fund are recorded on a cash basis.

Income taxes

PSP Investments is exempt from Part I tax under paragraph 149(1)(d) of the *Income Tax Act (Canada)*.

Use of estimates

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, related income and expenses and note disclosures. Actual results may differ from estimates.

2. INVESTMENTS

The Statement of Investment Portfolio provides details of investments held as at March 31, 2001.

(a) Investment Policy

PSP Investments has prepared an Interim Statement of Investment Policies, Standards and Procedures (the "Interim Investment Policy"), which sets out the manner in which the assets shall be invested for the Canadian Forces Pension Plan Account. Asset mix policy and benchmarks at March 31, 2001 were as follows:

ASSET CLASS	POLICY MIX	BENCHMARK
Canadian Equities	35.0%	TSE 300
U.S. Equities	13.5%	S&P 500
Non-North American Equities	13.5%	MSCI EAFE
Canadian Fixed Income	38.0%	SC Bond Universe

The regulations to the Act stipulate that the investments of PSP Investments in Canadian equities must substantially replicate the composition of one or more widely recognized broad market indexes. The Toronto Stock Exchange 300 Composite Index (TSE 300) has been selected as an appropriate market index for Canadian equities. Initially, PSP Investments is also utilizing a market replication strategy for the other asset classes.

(b) Foreign currency exposure

PSP Investments is exposed to currency risk through holdings of units in pooled funds of non-Canadian equities where investment values will fluctuate due to changes in foreign exchange rates. The underlying foreign currency exposures by geographical area as at March 31, 2001 were as follows:

COUNTRY/REGION	FAIR VALUE	% OF TOTAL
	(\$000)	
United States	\$ 71,294	50.3
Europe	49,424	34.8
Far East	21,143	14.9
	\$ 141,861	100.0

In accordance with the Interim Investment Policy, the foreign currency exposures are not hedged.

3. FUND TRANSFERS

During the year, PSP Investments received \$581,077,000 of transfers from the Canadian Forces Pension Fund. The transfers resulted from net current employer and employee contributions to the Canadian Forces Pension Plan.

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4. INVESTMENT PERFORMANCE

Portfolio and benchmark returns for the period from April 17, 2000 (the first day funds were invested) to March 31, 2001 were as follows:

	PORTFOLIO RETURNS	BENCHMARK RETURNS	
Canadian Equities	(11.9)%	(12.2)%	TSE 300
Foreign Equities	(13.2)%	(13.0)%	50% S&P500/ 50% EAFE
Canadian Fixed Income	8.3%	8.3%	SC Bond Universe
Total return	(4.2)%	(4.0)%	

The total return benchmark aggregates the benchmark returns according to the weightings specified in the Interim Investment Policy.

Returns have been calculated in accordance with the methods set forth by the Association for Investment Management and Research. Returns are presented gross of investment and administrative expenses.

5. INVESTMENT EXPENSES

Investment expenses consisted of the following:

	(\$000)
External investment management fees	\$ 41
Custodial fees	12
	\$ 53

6. ADMINISTRATIVE ACTIVITIES

The Act requires that the costs of operation of PSP Investments be charged to the three plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine which Plan Account these costs will be charged to, in consultation with the Minister of

National Defence and the Solicitor General of Canada. An allocation policy has been developed which allocates the direct costs of investment activities, such as investment management and custodial fees, to each Plan Account, and allocates administrative costs, such as advisory services, directors' fees and administration costs, based upon the asset value of each Plan Account. Administrative costs have been allocated according to the policy resulting in a full year allocation as follows:

Public Service Pension Plan Account	71.9%
Canadian Forces Pension Plan Account	21.0%
Royal Canadian Mounted Police Pension Plan Account	7.1%

The costs of operation are paid by the Public Service Pension Plan Account and recharged to the other Plan Accounts on a quarterly basis.

(a) Operating expenses

Operating expenses are allocated according to the allocation policy noted above and consisted of the following:

	(\$000)
Remuneration earned by directors	\$ 59
Communications expenses	59
Office supplies and equipment	57
Occupancy costs	18
Travel and accommodation for directors' meetings	17
Other operating expenses	9
	\$ 219

Total remuneration earned by directors before allocation to each Plan Account amounted to \$279,000. Remuneration earned by directors includes an annual retainer for each director of \$12,000, an additional annual retainer of \$3,000 for

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each committee chair, and Board and committee meeting fees of \$900 per meeting. Separate fees are not paid for investment committee meetings when they are held on the same day as Board meetings.

Commitments for premises and equipment total \$655,000 for the next two years, a portion of which will be allocated to this Plan Account.

(b) Salaries and benefits

Included in salaries and benefits is 21.0% of the total compensation earned by the President and Chief Executive Officer and the Executive Vice President of PSP Investments. The total compensation paid to the executive officers was as follows:

EMPLOYEE	POSITION	SALARY	SHORT-TERM BONUS	LONG-TERM BONUS
Adel Sarwat ¹	President and CEO	\$ 138,900	\$ 70,000	\$ —
Carl Haller ²	Executive Vice President	\$ 256,500	\$ —	\$ —

¹ The President and Chief Executive Officer commenced employment on September 11, 2000, and in addition to the above, was awarded a signing bonus of \$210,000.

² The Executive Vice President commenced employment on February 28, 2000 with the mandate to coordinate the start-up phase.

(c) Professional and consulting fees

Professional and consulting fees, of which 21.0% have been allocated to this Plan Account, consisted of the following:

	(\$000)
Consulting fees	\$ 180
Legal	97
Professional accounting and audit fees	46
	\$ 323

Consulting fees represent amounts paid for professional advice in connection with the development of business strategy and human resource policies, the search for executive officers, and other professional advice received by PSP Investments.