

Canadian Forces Pension Plan Account



Canadian Forces Pension Plan Account

Auditors' Report

To the Board of Directors of
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, 2004 and the Statements of Net Income (Loss) and Accumulated Net Income (Loss) from Operations 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, 2004 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 attention 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*.



Chartered Accountants
Toronto, Ontario
April 30, 2004

Canadian Forces Pension Plan Account

Balance Sheet

As at March 31

	2004 (\$,000)	2003 (\$,000)
ASSETS		
Investments – at fair value (Note 2)	2,971,057	1,730,757
Other assets	464	282
	2,971,521	1,731,039
LIABILITIES		
Bank overdraft (Note 3)	—	5,359
Accounts payable and accrued liabilities	884	488
Due to the Public Service Pension Plan Account (Note 6a)	1,268	1,257
	2,152	7,104
NET ASSETS	2,969,369	1,723,935
NET ASSETS REPRESENTED BY		
Accumulated net income (loss) from operations	297,328	(219,127)
Accumulated fund transfers	2,672,041	1,943,062
	2,969,369	1,723,935

On behalf of the Board of Directors:



Keith Martell

Director and Chair of the Audit and Conflicts Committee

Statement of Changes in Net Assets

For the year ended March 31

	2004 (\$,000)	2003 (\$,000)
NET ASSETS, BEGINNING OF YEAR	1,723,935	1,236,048
CHANGES IN NET ASSETS		
Fund transfers (Note 4)	728,979	687,973
Net income (loss) from operations	516,455	(200,086)
NET ASSETS, END OF YEAR	2,969,369	1,723,935

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Statement of Net Income (Loss) and Accumulated Net Income (Loss) from Operations

For the year ended March 31

	2004 (\$,000)	2003 (\$,000)
INVESTMENT INCOME AND GAINS (LOSSES)		
Interest and dividends	63,344	44,858
Net realized gains (losses)	37,909	805
Change in unrealized appreciation (depreciation) in value of investments	419,683	(242,917)
	520,936	(197,254)
EXPENSES (Note 6)		
Operating expenses (Note 6b)	2,582	1,970
External investment management fees	1,899	862
	4,481	2,832
NET INCOME (LOSS) FROM OPERATIONS	516,455	(200,086)
ACCUMULATED NET INCOME (LOSS) FROM OPERATIONS, BEGINNING OF YEAR	(219,127)	(19,041)
ACCUMULATED NET INCOME (LOSS) FROM OPERATIONS, END OF YEAR	297,328	(219,127)

Statement of Investment Portfolio

As at March 31

	2004		2003	
	Cost (\$,000)	Fair Value (\$,000)	Cost (\$,000)	Fair Value (\$,000)
Investments (Note 2)				
PSP Canadian Equities Fund 98,964,475.025539 units (2003 - 79,813,358.691790 units)	938,071	1,112,986	745,811	676,039
PSP Foreign Equities Fund 88,376,832.678660 units (2003 - 61,606,182.434812 units)	808,573	819,842	580,621	444,144
PSP Currency Overlay Fund 2,413,807.740989 units (2003 - Nil)	25,071	18,288	—	—
PSP Real Estate Fund 1,536,657.515258 units (2003 - Nil)	15,181	15,665	—	—
PSP Fixed Income Fund 93,040,969.189282 units (2003 - 54,722,438.406860 units)	971,320	999,893	563,305	558,319
PSP Cash Equivalents Fund 441,694.101721 units (2003 - 5,223,793.736824 units)	4,411	4,383	52,273	52,255
	2,762,627	2,971,057	1,942,010	1,730,757

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Notes to the Financial Statements

For the year ended March 31, 2004

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 maintains records of the Pension Fund's net contributions, as well as the allocation of its investments and the results of its operations to each of the Plan Accounts.

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*.

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, or the details of the pension contributions, payments and liabilities of the Canadian Forces Pension Fund. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Act.

Valuation of investments

Investments consist of the unit interest in PSP Investments' assets (The "PSP Funds") that are allocated to this Plan Account. 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 or other generally accepted pricing methodologies for the underlying securities.

Income recognition

The investment income has been allocated by PSP Investments according to the number of units of PSP Funds held by the Canadian Forces Pension Plan Account.

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends. These income items include the related distributions from PSP 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 end of the year are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses on foreign exchanges are included in investment income.

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Notes to the Financial Statements

For the year ended March 31, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, 2004.

(a) Investment Policy

PSP Investments has established a Statement of Investment Policies, Standards and Procedures, (the "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 as at March 31, 2004 were as follows:

Asset Class	Policy Mix	Benchmark
Canadian Equities	35.0%	S&P/TSX
Foreign Equities	30.0%	S&P 500, MSCI EAFE
Real Estate *	up to 5.0%	CPI + 4%
Fixed Income	32.0%	SC Bond Universe
Cash Equivalents	3.0%	SC 91-day T-bill

* Any investments in the Real Estate asset class will automatically reduce the designated target weight for the Fixed Income asset class.

(b) Investment asset mix

The investment asset mix, after allocating the impact of PSP Currency Overlay Fund, as at March 31 was as follows:

Asset Class	2004			2003		
	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)
Canadian Equities	938,071	1,112,986	37.5	745,811	676,039	39.0
Foreign Equities	808,573	822,767	27.7	580,621	444,144	25.7
Real Estate	15,181	15,665	0.5	—	—	—
Fixed Income	971,320	999,893	33.7	563,305	558,319	32.3
Cash Equivalents	29,482	19,746	0.6	52,273	52,255	3.0
	2,762,627	2,971,057	100.0%	1,942,010	1,730,757	100.0%

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For the year ended March 31, 2004

2. INVESTMENTS (continued)

(c) Foreign currency exposure

This Plan Account is exposed to currency risk through holdings of units in PSP Funds of non-Canadian assets where investment values will fluctuate due to changes in foreign exchange rates.

The underlying foreign currency exposures in Canadian Dollars, before allocating the economic impact of the PSP Currency Overlay Fund, as at March 31, were as follows:

Currency	2004		2003	
	Fair Value (\$,000)	% of Total	Fair Value (\$,000)	% of Total
US Dollars	458,542	55.8	261,300	58.9
Euro	136,730	16.6	67,400	15.2
Yen	90,092	11.0	37,743	8.5
British Pound	67,880	8.3	42,214	9.5
Others	68,492	8.3	35,146	7.9
	821,736	100.0%	443,803	100.0%

The fair value of PSP Foreign Equities Fund and PSP Currency Overlay Fund include \$1,031 thousand of Canadian dollars (2003 - \$341 thousand) which are not included in the foreign currency exposure.

Further details of Investments are shown in the PSP Investments Financial Statements.

3. BANK OVERDRAFT

The bank overdraft is an infrequent occurrence and arises from temporary requirements to settle security purchases prior to receiving the contribution from the Pension Fund. The amount is repaid within two business days.

4. FUND TRANSFERS

During the year, PSP Investments received \$729.0 million (2003 - \$688.0 million) of transfers from the Canadian Forces Pension Fund. The transfers result from net current employer and employee contributions to the Canadian Forces Pension Plan.

5. INVESTMENT PERFORMANCE

Portfolio and benchmark returns for the year ended March 31 were as follows:

	2004		2003		
	Portfolio Returns	Benchmark Returns	Portfolio Returns	Benchmark Returns	
Canadian Equities	36.1%	37.7%	(18.6)%	(17.6)%	S&P/TSX
Foreign Equities	30.7%	28.8%	(30.5)%	(29.9)%	S&P 500, MSCI EAFE
Real Estate	3.6%	2.5%	—	—	CPI + 4%
Fixed Income	10.9%	10.8%	9.4%	9.2%	SC Bond Universe
Cash Equivalents	3.2%	3.0%	3.2%	2.7%	SC 91-day T-bill
Total Return	26.1%	25.4%	(13.5)%	(12.9)%	

The total benchmark return aggregates the asset class benchmark returns according to the weights specified in the Investment Policy, as disclosed in Note 2 (a). The total return includes the impact of the PSP Currency Overlay Fund. Returns have been calculated in accordance with the mandatory requirements set forth by the Association for Investment Management and Research (AIMR). Returns are presented gross of expenses.

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Notes to the Financial Statements

For the year ended March 31, 2004

6. EXPENSES

(a) Allocation of expenses

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 to which Plan Account these costs will be charged, 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 external investment management fees and custodial fees, to each Plan Account, and allocates, on a quarterly basis, operating expenses excluding custodial fees, based upon the asset value of each Plan Account.

Operating expenses, excluding custodial fees, have been allocated as follows:

	2004	2003
Public Service Pension Plan Account	71.1%	70.4%
Canadian Forces Pension Plan Account	21.3%	21.9%
Royal Canadian Mounted Police Pension Plan Account	7.6%	7.7%

Expenses are financed by the Public Service Pension Plan Account, which is reimbursed by the other Plan Accounts on a quarterly basis.

(b) Operating expenses

Operating expenses allocated to this Plan Account consist of the following:

	2004	2003
	(\$,000)	(\$,000)
Salaries and benefits	1,189	995
General operating expenses	989	696
Professional and consulting fees	404	279
	2,582	1,970

Further details of Operating expenses are shown in the PSP Investments Financial Statements.