

## Auditors' report

To the Board of Directors  
Public Sector Pension Investment Board

We have audited the consolidated Balance Sheet and the consolidated Statement of Investment Portfolio of the Public Sector Pension Investment Board ("PSP Investments") as at March 31, 2005 and the consolidated Statements of Net Income from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of 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 consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments and the investments held as at March 31, 2005 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 PSP Investments and those of its subsidiaries that have come to our attention during our audit of the consolidated financial statements, have, in all significant respects, been in accordance with the *Public Sector Pension Investment Board Act* (the "Act") and the by-laws, and any by-laws of the subsidiaries, with the exception of the foreign property limits set out in the Statement of Investments Policies, Standards and Procedures which were exceeded during the period from March 15 to March 31, 2005 in anticipation of the adoption of the Federal Budget which provides for the elimination of the limits on investments in property that constitutes foreign property for the purposes of the *Income Tax Act* (Canada).

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 29, 2005

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Consolidated Balance Sheet

As at March 31

[\$000's]

	2005	2004
<b>ASSETS</b>		
Investments – at fair value (Note 2)	\$19,368,448	\$ 14,233,209
Cash	3,341	1,571
Other assets (Note 3)	4,508	3,039
	<b>19,376,297</b>	14,237,819
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	15,333	5,890
<b>NET ASSETS</b>	<b>\$19,360,964</b>	\$ 14,231,929
<b>NET ASSETS REPRESENTED BY</b>		
Public Service Pension Plan Account	\$13,975,270	\$10,205,922
Canadian Forces Pension Plan Account	3,961,356	2,969,369
Royal Canadian Mounted Police Pension Plan Account	1,424,338	1,056,638
	<b>\$19,360,964</b>	\$ 14,231,929

Commitments (Note 10)

On behalf of the Board of Directors:



Keith Martell

Director and Chair of the Audit and Conflicts Committee

## Consolidated Statement of Changes in Net Assets

For the year ended March 31

[\$000's]

	2005	2004
<b>NET ASSETS, BEGINNING OF YEAR</b>	<b>\$14,231,929</b>	\$ 8,095,712
<b>CHANGES IN NET ASSETS</b>		
Fund transfers (Note 4)	3,816,013	3,695,567
Net income from operations	1,313,022	2,440,650
<b>NET ASSETS, END OF YEAR</b>	<b>\$19,360,964</b>	\$ 14,231,929



# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Consolidated Statement of Net Income from Operations

For the year ended March 31

(\$000's)	2005	2004
<b>INVESTMENT INCOME (Note 5)</b>		
Interest and dividends	\$ 441,640	\$ 312,240
Net realized gains	432,138	192,369
Change in unrealized appreciation in value of investments	474,362	1,957,158
	<b>1,348,140</b>	2,461,767
<b>EXPENSES</b>		
Operating expenses (Note 7a)	20,793	12,110
External investment management fees	14,325	9,007
	<b>35,118</b>	21,117
<b>NET INCOME FROM OPERATIONS (Note 8)</b>	<b>\$ 1,313,022</b>	\$ 2,440,650

## Consolidated Statement of Investment Portfolio

As at March 31

(\$000's)	2005		2004	
Investments (Note 2)	Cost	Fair Value	Cost	Fair Value
<b>PSP Canadian Equities Fund</b>				
Active management	\$ 3,801,302	\$ 4,581,405	\$ 2,092,955	\$ 2,467,869
Indexed management	2,624,880	3,176,137	2,456,707	2,863,973
	<b>6,426,182</b>	<b>7,757,542</b>	4,549,662	5,331,842
<b>PSP Foreign Equities Fund</b>				
Active management	3,285,107	3,463,143	1,419,440	1,612,849
Indexed management	1,763,889	1,816,167	2,234,584	2,314,825
	<b>5,048,996</b>	<b>5,279,310</b>	3,654,024	3,927,674
<b>PSP Private Equities Fund</b>				
Private Equities investment (Note 2h)	3,618	2,995	—	—
<b>PSP Real Estate Fund</b>				
Real Estate investment (Note 2i)	90,985	98,240	72,042	74,342
<b>PSP Foreign Real Estate Fund</b>				
Real Estate investment (Note 2i)	390,595	385,419	—	—
<b>PSP Hedging Fund</b>				
Net cash and derivative instruments	15,110	15,625	—	—
<b>PSP Fixed Income Fund</b>				
Active management	2,585,533	2,629,590	2,192,974	2,252,362
Indexed management	2,993,842	3,020,202	2,517,941	2,559,399
	<b>5,579,375</b>	<b>5,649,792</b>	4,710,915	4,811,761
<b>PSP Absolute Return Fund</b>				
Net cash and derivative instruments	181,619	179,525	88,960	87,590
	<b>\$ 17,736,480*</b>	<b>\$ 19,368,448*</b>	\$ 13,075,603*	\$ 14,233,209*

\* Includes investment receivables of \$55.7 million (2004 – \$19.1 million) and investment payables of \$81.9 million (2004 – \$58.0 million) pertaining to pending trades and forward currency contracts for a net payable of \$26.2 million (2004 – \$38.9 million). Also includes accrued income of \$37.3 million (2004 – \$36.0 million).

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 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.

The Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds were established by amendments to the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* and the *Royal Canadian Mounted Police Superannuation Act* (the "Superannuation Acts"), 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 each Pension Fund, to their respective PSP Investments-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 *Superannuation Acts*. 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 pension plans established under the *Superannuation Acts*.

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of presentation**

These consolidated 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 Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of all three Pension Funds. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Act. These consolidated financial statements include the accounts of PSP Investments and, from the respective date of creation, its wholly-owned subsidiaries.

#### **Plan Accounts**

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

Separate financial statements for each Plan Accounts have been published.

#### **Valuation of investments**

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

Fair values of investments are determined as follows:

- (a) Short-term deposits are recorded at cost which, together with accrued interest income, approximates fair value.
- (b) Market prices for equities and unit values for pooled funds are used to represent the fair value of investments. Unit values reflect the quoted market prices of the underlying securities.
- (c) Private Equity investments, where quoted market prices are not available, are fair-valued annually by external managers of pooled funds or of limited partnerships in which the investments are made. The fair value is determined by the external managers using acceptable industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flows and third party transactions.



## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### **Valuation of investments (continued)**

(d) The fair value of investments in Real Estate is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions.

In the first year of ownership, the fair value of direct investments is based on the net book value of such investments, using the purchase price of the underlying assets. If the investment is denominated in foreign currency, the fair value reflects the change in foreign exchange rates.

(e) Fixed Income securities are valued at year-end quoted market prices where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

(f) Derivative instruments, including swaps, futures, options and forward contracts are valued at year-end quoted market prices where available. Where quoted market prices are not available, estimated values are calculated using methods such as discounted cash flows using market yields and other pricing models, as appropriate.

#### **Income recognition**

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 pooled funds and limited partnerships.

#### **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 exchange are included in investment income.

#### **Fund transfers**

Amounts received from each Pension Fund are recorded on a cash basis in their respective Plan Account.

#### **Income Taxes**

PSP Investments and certain of its subsidiaries are exempt from Part I tax under paragraph 149(1) (d) of the *Income Tax Act* (Canada).

#### **Use of estimates**

In preparing these consolidated 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.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS

The Consolidated Statement of Investment Portfolio provides details of investments held as at March 31, 2005.

#### (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 three Plan Accounts.

Target asset mix policy and benchmarks, as at March 31, 2005, were as follows:

Asset Class	Policy Mix	Benchmark
<b>Cash Equivalents</b>	2%	SC 91 day T-Bill
<b>Bonds</b>		
Fixed Return	20%	SC Universe
Real Return <sup>(1)</sup>	5%	SC RRB
<b>Public &amp; Private Equities</b>		
<b>Public Equities</b>		
Canadian Equity	30%	S&P TSX
US Equities		
Large Cap	5%	S&P 500
Small Cap	5%	S&P 600
EAFE Equity	8%	MSCI EAFE
Emerging Equity	7%	MSCI EMF
<b>Private Equity</b> <sup>(2)</sup>	8%	S&P 600 <sup>(1/3)</sup> and S&P 400 <sup>(2/3)</sup> + 4%
<b>Real Estate</b> <sup>(3)</sup>	10%	CPI +5.5%

(1) Real Return Bonds ("RRB") target weight is 5%. Until the target weight of 5% is reached, assets destined for RRB's will be invested in Fixed Income and measured against the SC Universe.

(2) Private Equity ("PE") target weight is 8%. Until the target weight of 8% is reached, assets destined for PE will be invested in Public Equities and measured against the corresponding public equity benchmarks.

(3) Real Estate ("RE") target weight is 10%. Until the target weight of 10% is reached, assets destined for RE will be invested in a short-term bond benchmarked to the SM ST Fed. Gov. Index.



# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS (continued)

#### (b) Investment asset mix

The investment asset mix, as at March 31, was as follows:

Asset Class	2005		2004	
	Fair Value (\$000's)	% of Portfolio	Fair Value (\$000's)	% of Portfolio
<b>Cash Equivalents</b>	<b>\$ 437,926</b>	<b>2.3%</b>	\$ 95,455	0.7%
<b>Bonds</b>				
Fixed Return	5,142,507	26.6	4,789,891	33.6
Real Return	219,490	1.1	—	—
<b>Public &amp; Private Equities</b>				
<b>Public Equities</b>				
Canadian Equity	7,757,542	40.1	5,331,842	37.5
US Equities				
Large Cap	2,314,191	12.0	2,124,900	14.9
Small Cap	105,178	0.5	65,040	0.5
EAFE Equity	2,505,913	12.9	1,737,735	12.2
Emerging Equity	354,029	1.8	—	—
Private Equity	2,995	—	—	—
<b>Real Estate</b>	<b>429,071</b>	<b>2.2</b>	74,342	0.5
<b>Absolute Return Strategies</b>	<b>99,606</b>	<b>0.5</b>	14,004	0.1
	<b>\$19,368,448</b>	<b>100.0%</b>	\$14,233,209	100.0%

Direct investments, derivative contracts, and investment-related receivables and liabilities are classified by asset-mix category based on the intent of the investment strategies of the underlying portfolios of PSP Investments.

#### (c) Changes in PSP Funds

On November 30, 2004, PSP Investments restructured its funds.

The nature of the PSP Fixed Income Fund has changed to include cash equivalent investments. As a result, the investments previously held in the PSP Cash Equivalents Fund were transferred into the PSP Fixed Income Fund. For comparative purposes, the amount shown as PSP Cash Equivalents Fund for the prior year has been reclassified.

The PSP Foreign Real Estate Fund was created to hold foreign real estate investments.

The PSP Absolute Return Fund was created and investments previously held in the PSP Currency Overlay Fund were transferred to it. For comparative purposes, the amount shown as PSP Currency Overlay Fund for the prior year has been reclassified.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS (continued)

#### (d) Foreign currency exposure

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets where investment values will fluctuate due to changes in foreign exchange rates. To mitigate this risk, PSP Investments may take, through derivative contracts, trading positions in foreign currencies.

The underlying net foreign currency exposures, as at March 31, were as follows:

Currency (in Canadian \$)	2005		2004	
	Fair Value (\$000's)	% of Total	Fair Value (\$000's)	% of Total
US Dollars	\$ 2,750,457	49.8%	\$ 2,196,766	55.8%
Euro	958,352	17.3	655,043	16.6
British Pound	521,480	9.4	325,194	8.3
Yen	497,156	9.0	431,609	11.0
Others	799,325	14.5	328,131	8.3
	\$ 5,526,770	100.0%	\$ 3,936,743	100.0%

PSP Investments and its subsidiaries also have commitments in real estate-related investments for an amount of \$276.4 million (\$216.7 million US and £6.2 million GBP) which is not included in the foreign currency exposure table above.

#### (e) Credit risk

Credit risk arises in the Cash Equivalents, the Fixed Income and the Real Estate asset classes. Credit risk is managed through minimum DBRS (or equivalent) rating requirements, and for the Real Estate class, by performing thorough due diligence analysis.

PSP Investments' highest concentration of credit risk is with the Government of Canada through its holding of \$2.0 billion of Government of Canada issued securities. PSP Investments, to minimize derivative contract credit risk, deals only with counterparties, which are major financial institutions with a minimum credit standard rating of "A", as supported by a recognized credit rating agency.

#### (f) Market risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, or factors affecting all securities traded in the market. PSP Investments has a diversification strategy to manage this risk.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS (continued)

#### (f) Market risk (continued)

*PSP Canadian Equities Fund – 10 largest holdings*

Company Name	Fair Value	% of PSP Canadian Equities Fund
	(\$000's)	
1 Royal Bank of Canada	\$ 382,408	4.9%
2 Manulife Financial Corporation	374,213	4.8
3 Bank of Nova Scotia	339,914	4.4
4 Encana Corporation	316,115	4.1
5 Toronto Dominion Bank	259,690	3.3
6 Canadian Imperial Bank of Commerce	200,764	2.6
7 Talisman Energy Inc.	186,579	2.4
8 Bank of Montreal	170,029	2.2
9 BCE Inc.	169,290	2.2
10 Sun Life Financial Inc.	141,279	1.8
<b>Total 10 largest Holdings</b>	<b>\$ 2,540,281</b>	<b>32.7%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

*PSP Foreign Equities Fund – 10 largest holdings*

Company Name	Fair Value	% of PSP Foreign Equities Fund
	(\$000's)	
1 Vodafone Group	\$ 74,847	1.4%
2 Royal Dutch Petroleum Company	61,197	1.1
3 United Health Group Inc.	59,801	1.1
4 Citigroup Inc.	59,408	1.1
5 Nextel Communications Inc.	51,897	1.0
6 Tyco International Ltd	49,966	1.0
7 General Electric Company	48,190	1.0
8 Exxon Mobil Corporation	48,094	1.0
9 JP Morgan Chase & Company	45,871	1.0
10 Total SA	45,327	1.0
<b>Total 10 largest Holdings</b>	<b>\$ 544,598</b>	<b>10.7%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS (continued)

#### **(f) Market risk (continued)**

The PSP Fixed Income Fund holds securities invested in Canada as follows:

	Fair Value (\$000's)	% of PSP Fixed Income Fund
Government of Canada	\$ 1,960,170	34.7%
Provincial	1,263,705	22.4
Municipal	23,281	0.4
Corporate	2,105,765	37.3
Cash and Cash Equivalents	296,871	5.2
<b>Total of PSP Fixed Income Fund</b>	<b>\$ 5,649,792</b>	<b>100.0%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

As at March 31, 2005, 47% of the PSP Fixed Income Fund was managed actively with a duration of 4.8 years (a 1% increase in interest rates would result in a decline in the value of the actively managed fixed income securities of 4.8%). The balance of portfolio is managed passively against the SC Bond Universe index. The index has a duration of 6.2 years.

#### **(g) Securities lending**

PSP Investments participates in securities lending programs whereby it lends securities it owns to other parties. Any such securities lending requires collateral in cash or high quality debt instruments or shares securities with a fair value equal to no less than 105% of the value of the securities lent. As at March 31, 2005, securities with an estimated fair value of \$1,981.2 million (2004 – \$763.9 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of \$2,118.4 million (2004 – \$805.9 million).

#### **(h) PSP Private Equity Fund**

The PSP Private Equity Fund comprises an interest in a limited partnership with an expected term of 10 years. The fund is managed by a General Partner. Management fees are 2% of the total amount committed to the fund and are paid directly by the fund.



# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 2. INVESTMENTS (continued)

#### (i) Real Estate Investments

The PSP Real Estate Fund and PSP Foreign Real Estate Fund comprise real estate-related investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by General Partners or external advisors. The underlying investments comprise a diversified portfolio of income-producing properties.

Investment management fees for these real estate investments are generally incurred by the partnerships and funds. Therefore, PSP Investments' gains (losses) on investments are net of those fees.

The underlying real estate exposures by location as at March 31, were as follows:

Location	2005		2004	
	Fair Value (\$000's)	% of total	Fair Value (\$000's)	% of total
Canada	\$ 117,135	27.3%	\$ 74,342	100.0%
United States	300,710	70.1	—	—
Western Europe	9,754	2.3	—	—
Asia	1,472	0.3	—	—
	<b>\$ 429,071</b>	<b>100.0%</b>	<b>\$ 74,342</b>	<b>100.0%</b>

#### (j) Derivative Financial Instruments

Derivative financial instruments are financial contracts, the value of which is derived from underlying assets or interest or exchange rates.

PSP Investments uses derivative financial instruments to reduce the risk associated with an existing investment or, as an alternative to holding or investing in the underlying asset itself. Derivative financial instruments also assist in the management of financial risks, including interest rate risk and foreign exchange risk.

The following table summarizes PSP Investments derivatives portfolio as at March 31:

(\$000's)	2005		2004	
	Notional Value*	Fair Value	Notional Value*	Fair Value
<b>Equity derivatives</b>				
Swaps	\$ 365,581	\$ 1,314	—	—
Futures	94,987	(436)	—	—
Options	4,597	484	—	—
<b>Currency derivatives</b>				
Forwards	261,695	(2,091)	\$ 374,561	\$ (7,000)
Options	181,475	3,552	785,775	13,294
		<b>\$ 2,823</b>		<b>\$ 6,294</b>

\* Notional value represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows and it does not represent the potential gain, loss or net exposure associated with the market or credit risk of such transactions. Rather, it serves as the basis upon which the returns from, and the fair value of the contracts, are determined. All amounts are in Canadian dollars.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 3. OTHER ASSETS

Other assets as at March 31 consist of the following:

(\$000's)	2005	2004
Fixed assets	\$ 2,281	\$ 2,152
Other assets	1,576	887
Real estate receivables	651	—
	<b>\$ 4,508</b>	<b>\$ 3,039</b>

### 4. FUND TRANSFERS

During the year, PSP Investments received \$3,816.0 million (2004 - \$3,695.6 million) of transfers from the three Pension Funds. The transfers result from net current employer and employee contributions to their respective Pension Plan.

The breakdown of the fund transfers for the year ended March 31 is as follows:

(\$000's)	2005	2004
Public Service Pension Fund	\$ 2,825,086	\$ 2,708,522
Canadian Forces Pension Fund	720,665	728,979
Royal Canadian Mounted Police Pension Fund	270,262	258,066
Total fund transfers	<b>\$ 3,816,013</b>	<b>\$ 3,695,567</b>

### 5. INVESTMENT INCOME

#### (a) Investment income

Investment income, before allocating the net realized and unrealized gains on investments to asset classes, for the year ended March 31, is as follows:

(\$000's)	2005	2004
<b>Interest – Bearing Investments</b>		
Short-term	\$ 14,572	\$ 4,881
Canadian bonds and debentures	222,613	178,741
	<b>237,185</b>	183,622
<b>Equity Investments</b>		
Canadian equities dividends	113,306	71,819
Foreign equities dividends	84,002	55,602
	<b>197,308</b>	127,421
<b>Real Estate Investments</b>	<b>7,147</b>	1,197
<b>Total interest and dividends</b>	<b>441,640</b>	312,240
<b>Net gain on investments</b>	<b>906,500</b>	2,149,527
<b>Investment income</b>	<b>\$ 1,348,140</b>	<b>\$ 2,461,767</b>

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 5. INVESTMENT INCOME (continued)

#### (b) Investment income by Asset Class

Investment income by asset class for the year ended March 31, is as follows:

(\$000's)	2005	2004
<b>Asset Class</b>		
Cash Equivalents	\$ 35	\$ 4,881
Fixed Income	245,112	369,396
Canadian Equities	1,012,918	1,275,930
Foreign Equities <sup>1</sup>	83,935	808,064
Real Estate	11,119	3,496
Private Equity	(623)	—
Absolute Return	(4,356)	—
	<b>\$ 1,348,140</b>	<b>\$ 2,461,767</b>

1 Including foreign currency realized loss of \$15.5 million (2004 – realized gain of \$2.0 million) and foreign currency unrealized loss of \$159.4 million (2004 – unrealized gain of \$152.3 million)

Derivative contracts are classified by asset-mix category based on the intent of the investment strategies of the underlying portfolios of PSP Investments.

### 6. INVESTMENT PERFORMANCE

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

	2005		2004	
	Portfolio Returns	Benchmark Returns	Portfolio Returns	Benchmark Returns
Cash Equivalents	2.9%	2.2%	3.2%	3.0%
Fixed Income	5.0%	4.7%	10.9%	10.8%
Canadian Equities	15.7%	13.9%	36.1%	37.7%
Foreign Equities	1.7%	1.5%	30.7%	28.8%
Real Estate	7.9%	6.7%	3.6%	2.5%
<b>Total Return</b>	<b>7.9%</b>	<b>7.2%</b>	<b>26.1%</b>	<b>25.4%</b>

The total benchmark return aggregates the asset class benchmark returns according to the weights specified in the Investment Policy. The total return includes the impact of the PSP Hedging Fund and the PSP Absolute Return Fund. Returns have been calculated in accordance with the methodology recommended by the CFA Institute. Returns are presented gross of expenses.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 7. EXPENSES

#### (a) Operating expenses

Operating expenses consist of the following:

(\$000's)	2005	2004
Salaries and benefits	\$ 10,570	\$ 5,582
Professional and consulting fees*	3,046	1,867
Office supplies and equipment	2,461	1,476
Custody	994	460
Occupancy costs	770	729
Depreciation of fixed assets	749	621
Remuneration earned by Directors	536	434
Communication expenses	148	224
Travel and related expenses for Directors	123	177
Other operating expenses	1,396	540
	<b>\$ 20,793</b>	<b>\$ 12,110</b>

\* Included in Professional and consulting fees are audit and audit-related fees of \$653,000 (2004 – \$428,000) and non-audit fees of \$21,000 (2004 – Nil) that were paid and accrued to the external auditors of PSP Investments.

Total remuneration earned by Directors in fiscal year 2005 includes 1) an annual retainer of \$98,000 for the Board Chairperson and of \$20,000 for each Director; 2) an annual retainer of \$7,500 for each committee chair; 3) Board meeting fees of \$1,500 per meeting (\$500 for meetings less than one hour); 4) Committee meeting fees of \$1,000 per meeting (\$500 for meetings less than one hour) and 5) a travel time meeting fee of \$1,000 if distance to and from the meeting is greater than 1,000 km from the director's primary residence. Separate fees are not paid for investment committee meetings when they are held as a committee of the whole during Board meetings. The Board Chairperson is not eligible for Board and committee meeting fees.

Directors of PSP Investments come from various regions of the country and accordingly they incur travel and accommodation expenses in attending meetings of the Board and committees.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 7. EXPENSES (continued)

#### (b) Salaries and benefits

Included in salaries and benefits is compensation earned by executive officers. The total compensation earned during the fiscal year by the executive officers was as follows:

Employee / Position	Year	Base Salary	Annual Bonus <sup>6</sup>	Long Term Incentive Plan <sup>6</sup>	Benefits <sup>7</sup>	Total Compensation
		(\$)	(\$)	(\$)	(\$)	(\$)
<b>Gordon J. Fyfe <sup>1</sup></b>	<b>2005</b>	<b>385,000</b>	<b>454,300</b>	<b>184,800</b>	<b>36,000</b>	<b>1,060,100</b>
President and Chief Executive Officer	2004	188,000	244,000	—	17,000	449,000
<b>André Collin <sup>2</sup></b>	<b>2005</b>	<b>221,000</b>	<b>324,000</b>	—	<b>23,000</b>	<b>568,000</b>
First Vice President, Real Estate Investments						
<b>Derek Murphy <sup>3</sup></b>	<b>2005</b>	<b>200,000</b>	<b>224,000</b>	—	<b>41,000</b>	<b>465,000</b>
First Vice President, Private Equity	2004	—	—	—	—	—
<b>Pierre Malo <sup>4</sup></b>	<b>2005</b>	<b>200,000</b>	<b>119,600</b>	—	<b>24,000</b>	<b>343,600</b>
First Vice President and Co-Chair of the Management Investment Committee	2004	65,000	78,500	—	8,000	151,500
<b>Danielle G. Morin <sup>5</sup></b>	<b>2005</b>	<b>194,000</b>	—	—	<b>28,000</b>	<b>222,000</b>
First Vice President and Chief Financial Officer (CFO)	2004	208,000	144,000	—	29,000	381,000

1 The President and Chief Executive Officer commenced employment on October 9, 2003, and in addition to the above, was awarded a signing bonus of \$450,000 in fiscal year 2004.

2 The First Vice President, Real Estate Investment commenced employment on May 17, 2004.

3 The First Vice President, Private Equity commenced employment on March 31, 2004, and was awarded a signing bonus of \$51,000 in fiscal year 2004. Benefits include an amount for relocation assistance.

4 The First Vice President and Co-Chair of the Management Investment Committee commenced employment on December 8, 2003, and in addition to above, was awarded a signing bonus of \$325,000 in fiscal year 2004.

5 The First Vice President and CFO left PSP Investments on March 15, 2005. The Bonus for fiscal year 2004 includes a special bonus of \$50,000 for being acting CEO.

6 Bonus awards include short-term and long-term components and are based on the achievement of agreed objectives. PSP Investments has modified its program for the short-term and long-term bonus in fiscal year 2005.

7 Benefits include other miscellaneous non-cash remuneration. In addition to the above, the executive officers are covered by a contributory defined benefit pension plan which provides them with a pension benefit of 2% of the best three years average earnings for each year of service. Furthermore, the President and CEO, the CFO and the First Vice President, Real Estate are members of a supplementary executive retirement plan.

### 8. ALLOCATION OF NET INCOME FROM OPERATIONS

The allocation of the net income from operations of PSP Investments to each Plan Account is as follows:

#### (a) Investment Income

The investment income has been allocated according to the number of units of PSP funds held by each Plan Account.

# PUBLIC SECTOR PENSION INVESTMENT BOARD

## Notes to the Consolidated Financial Statements

For the year ended March 31, 2005

### 8. ALLOCATION OF NET INCOME FROM OPERATIONS (continued)

#### (b) 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:

	2005	2004
Public Service Pension Plan Account	71.7%	71.1%
Canadian Forces Pension Plan Account	20.9%	21.3%
Royal Canadian Mounted Police Pension Plan Account	7.4%	7.6%
	100.0%	100.0%

Expenses are paid by PSP Investments by way of an advance from the Public Service Pension Plan Account, which is reimbursed by the other Plan Accounts on a quarterly basis.

### 9. GUARANTEES AND INDEMNITY

PSP Investments provides guarantees to its directors. Under these agreements, PSP Investments may be required to compensate, without limitation but subject to the Act, these parties for costs incurred, such as claims, actions or litigations. This indemnity is explicitly declared to be in excess and in addition to any indemnity of any policy of insurance purchased and maintained by PSP Investments under the subsection 18 (1) of the Act. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

### 10. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2005, the outstanding commitments, in funds and real estate-related investments amounted to \$320.7 million (\$26.4 million for private equity investments and \$294.3 million for real estate investments).

Subsequent to March 31, 2005, PSP Investments and its subsidiaries entered into investment transactions which will be funded over the next several years in accordance with agreed terms and conditions. The total commitments resulting from these transactions, in funds and real estate-related investments amounted to \$29.2 million, of which \$9.0 million was paid after year-end.

### 11. COMPARATIVE FIGURES

Certain comparative figures have been reclassified in order to conform to the current year presentation.

