PROVINCE OF NOVA SCOTIA
NOVA SCOTIA TEACHERS' PENSION FUND
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

NOVA SCOTIA

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Auditor's Report

To the Members of the Legislative Assembly of Nova Scotia; and

To the Minister of Finance

I have audited the consolidated statement of net assets available for benefits and accrued pension benefits net of deficiency of the Nova Scotia Teachers' Pension Fund as at December 31, 2003 and the consolidated statement of changes in net assets available for benefits for the year then ended. These consolidated 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 consolidated financial statements present fairly, in all material respects, the net assets available for benefits and accrued pension benefits net of deficiency of the Fund as at December 31, 2003 and the changes in net assets available for benefits for the year then ended in accordance with Canadian generally accepted accounting principles.

E. R. Salmon

E. Roy Salmon, FCA
Auditor General

Halifax, Nova Scotia
April 8, 2004

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CONSOLIDATED STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND ACCRUED PENSION BENEFITS NET OF DEFICIENCY
AS AT DECEMBER 31, 2003

	2003	2002
NET ASSETS AVAILABLE FOR BENEFITS	(000's)	(000's)
Assets		
Investments (Note 4)	$ 3,661,083	$ 3,230,736
Receivable from the Province of Nova Scotia (Note 1)	59,178	84,376
Contributions receivable		
Employees'	1,246	1,564
Employers'	4,789	4,137
Net investment transactions outstanding	–	30,095
Accrued income	22,088	20,956
Prepayment	440	–
Cash	974	1,092
Total assets	3,749,798	3,372,956
Liabilities		
Net investment transactions outstanding	7,061	–
Accounts payable	22,928	22,244
Total liabilities	29,989	22,244
Net assets available for benefits	3,719,809	3,350,712
Actuarial asset value adjustment (Note 5)	–	14,043
Actuarial value of net assets available for benefits	$ 3,719,809	$ 3,364,755
ACCRUED PENSION BENEFITS NET OF DEFICIENCY		
Accrued pension benefits (Note 6)	$ 4,591,045	$ 4,380,224
Deficiency (Note 6)	(871,236)	(1,015,469)
Accrued pension benefits net of deficiency	$ 3,719,809	$ 3,364,755

Approved:

Trustee - Minister of Finance

See accompanying notes to consolidated financial statements.

PROVINCE OF NOVA SCOTIA
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CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
FOR THE YEAR ENDED DECEMBER 31, 2003

	2003	2002
	(000's)	(000's)
Increase In Assets		
Investment activities (Note 4)	$ 468,255	$ –
Interest - Receivable from Province of Nova Scotia	5,544	8,787
	473,799	8,787
Contributions		
Employers' - matched	53,765	50,437
Employees' - matched	53,765	50,437
Employer's - unmatched - Province	15,977	18,058
Employees' - unmatched	1,598	1,934
Transfers from other pension plans	1,160	1,723
	126,265	122,589
Total increase in assets	600,064	131,376
Decrease In Assets		
Investment activities (Note 4)	–	162,120
Benefits paid	219,795	207,158
Operating expenses (Note 7)	7,890	7,877
Refund of contributions and interest and transfers to other pension plans	3,282	2,227
Total decrease in assets	230,967	379,382
Increase (Decrease) in Net Assets	369,097	(248,006)
Net Assets Available for Benefits at Beginning of Year	3,350,712	3,598,718
Net Assets Available for Benefits at End of Year	$ 3,719,809	$ 3,350,712

See accompanying notes to consolidated financial statements.

PROVINCE OF NOVA SCOTIA
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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1. Authority and Description of Plan

The Teachers' Pension Fund (the "Fund") was established by the Teachers' Pension Act (the "Act"). It is the funding vehicle for the Teachers' Pension Plan (the "Plan"), a pension plan which covers public school and community college teachers. The detailed provisions of the Plan, including pension eligibility criteria and benefit formulas are also contained in the Act and in the Regulations made under the Act.

The following description is a summary only. For more complete information, reference should be made to the Plan agreements.

Employee and employer contributions and investment earnings are credited to the Fund. Pensions, payments to terminating employees and administration expenses are charged to the Fund. The Minister of Finance is trustee of the Fund which is invested in federal, provincial, municipal and corporate securities which qualify as eligible investments under the Provincial Finance Act.

The Plan is funded by employee and matching employer contributions of 8.3% of salary up to the Year's Maximum Pensionable Earnings ("YMPE") per the Canada Pension Plan ("CPP") and 9.9% of salary above the YMPE. The basic pension formula is 2% for each year of pensionable service times the number of years of pensionable service. Pensions are integrated with CPP benefits at age 65. Pensions in pay are increased on January 1 of each year at a rate equal to the increase in the Consumer Price Index for Canada less 1%, to a maximum of 6%.

Plan members are eligible for a pension upon reaching any of the following criteria:
- 35 years of service;
- age 50 with 30 years of service (reduced pension);
- age 55 with an age plus pensionable service factor of 85 - "Rule of 85";
- age 55 with two years of service (reduced pension);
- age 60 with 10 years of service;
- age 65 with two years of service.

On July 22, 1994 the Governor in Council authorized an early retirement program (ERP) for Plan members. Each employing school board was required to pay into the Plan an amount in respect of each eligible teacher in the employ of the school board who retired in accordance with these regulations. This receivable is repayable over 8 years and bears interest at 8%. At December 31, 2003 the balance outstanding was $59.2 million (December 31, 2002 - $84.4 million). Order-in Council 2002-181 dated April 26, 2002 transferred responsibility for making these payments from the school boards to the Province.

PROVINCE OF NOVA SCOTIA
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2. Summary of Significant Accounting Policies

(a) Basis of Presentation

These consolidated financial statements are prepared on the going concern basis and present the aggregate financial position of the Fund as a separate financial reporting entity. In the event there are insufficient funds within the Fund to make all payments required by the Act, the Province of Nova Scotia guarantees cash flow assistance with respect to the pension benefits in pay. These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles.

(b) Consolidation

The Fund holds certain real estate investments through wholly-owned subsidiaries. The consolidated financial statements include the financial statements of the Plan and its subsidiaries.

(c) Foreign Currency Translation

Transactions denominated in foreign currencies are translated into Canadian dollars at the rates of exchange prevailing on the dates of the transactions. The market value of foreign investments and cash balances held at year-end are translated at the rates in effect at the year-end date. The resulting gain or loss from changes in these rates is included in current period change in market value of investments.

(d) Investments

(i) Investments are reported as of the trade date and are stated at market value as at year-end. Market 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.

(ii) The derivative contracts held by the Fund are recorded at market value with the resulting gains or losses being recognized in the realized and unrealized gains or losses on investments.

2. Summary of Significant Accounting Policies (continued)

(iii) Real estate is composed of income producing properties and real estate pooled funds. Unless recently acquired, properties are valued annually, by independent appraisers in accordance with generally accepted appraisal practices and procedures. This process utilizes discounted future cash flows. In estimating future cash flows certain assumptions are made with respect to future economic conditions and rates of return.

The fair value of any real estate which has been recently acquired is based on the purchase price.

(e) Investment income/loss

Investment income/loss, which includes interest, dividends and operating income/loss from real estate, is recorded on the accrual basis. Also included are gains and losses that have been realized on disposal of investments and the unrealized appreciation and depreciation in the fair value of investments.

(f) Non-Investment Assets and Liabilities

The fair value of receivable from the Province of Nova Scotia, contributions receivable, accrued income, other receivables, cash, net investment transactions outstanding and accounts payable approximate their carrying amounts due to their short-term nature.

(g) Contributions

Basic contributions from employers and members due to the Plan as at the end of the year are recorded on an accrual basis. Service purchases that include but are not limited to leaves of absence and transfers from other pension plans are recorded when received.

2. Summary of Significant Accounting Policies (continued)

(h) Benefits

Benefit payments to retired members, commuted value payments and transfers to other pension plans are recorded in the period in which they are paid. Accrued benefits are recorded as part of accrued actuarial liabilities.

(i) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of changes in net assets available for benefits during the year. Actual results could differ from these estimates.

3. Agreement to Address Unfunded Liability

On November 25, 1993, the Act was amended to incorporate the terms of an agreement signed May 13, 1993 between the Nova Scotia Teachers' Union and the Province of Nova Scotia to address the unfunded liability in the Plan.

As part of this agreement the Province agreed to pay $300 million into the Fund. By July 18, 1997 the Province had paid the amount in full.

The Province also agreed to make payments over a ten year period equal to $10 million per year in 1993, increased by 7.5% per year. This commitment is set out in Schedule B of the Teachers' Pension Act (Note 5). The last payment under Schedule B was received in August 2003.

Under the terms of the agreement a review of the Plan's financial status was to be carried out in 2003. The Teachers' Pension Partners Board established a committee (2003 Review Committee) to undertake this review. The committee is continuing its deliberations and has yet to report to the Board.

4. Investments and Derivatives

The investment objectives of the Plan are to provide long-term security of pension benefits to members and to minimize any increases in contributions required by members and the employer. A strategy of investing in assets of Canadian and foreign equities, bonds, debentures, mortgages and money market securities is aimed at achieving these objectives.

(a) Market value of investments and related income before allocating the effects of derivative contracts.

	As at December 31, 2003		For the Year	As at December 31, 2002		For the Year
	Assets	%	Income *	Assets	%	Income (Loss) *
	(000's)		(000's)	(000's)		(000's)
Money market	$ 536,195	14.7	$ 10,417	$ 276,780	8.6	$ 5,079
Fixed income	1,096,223	29.9	90,175	1,229,884	38.1	124,021
Equities						
Canadian	1,115,246	30.5	242,494	898,299	27.8	(75,239)
US	578,837	15.8	57,160	530,382	16.4	(120,005)
Other foreign	279,114	7.6	25,929	253,346	7.8	(63,321)
Real estate – Canadian	9,356	0.3	301	–	–	–
Real estate – Pooled fund	37,537	1.0	2,468	35,409	1.1	465
Derivatives	8,575	0.2	39,285	6,636	0.2	(33,146)
Other	–	–	26	–	–	26
	$ 3,661,083	100.0	$ 468,255	$ 3,230,736	100.0	$(162,120)

* Includes realized losses of $6.6 million ($14.1 million - 2002) and unrealized gains of $327.6 million (unrealized losses of $231.8 million – 2002).

(b) Derivative contracts

Derivatives are financial contracts, the value of which is 'derived' from the value of underlying assets or interest or exchange rates. Derivatives provide flexibility in implementing investment strategy.

Money market-to-equity swaps have been used during the year to adjust the asset mix.

Bond futures are contractual agreements to buy or sell the financial instrument at the contracted date and price. Bond futures have been used to adjust duration and risk profile during the year.

4. Investments and Derivatives (Continued)

The Fund is exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments. In order to mitigate this risk, the Fund:

- deals only with highly rated counterparties, with whom International Swap and Derivative Association agreements have been executed, normally major financial institutions with minimum credit standard of "A" rating, as supported by a recognized credit rating agency; and
- enters into derivatives only for the purpose of managing risk.

Credit risk represents the maximum amount that would be at risk as at the reporting date if the counterparties failed completely to perform under the contracts, and if the right of offset proved to be non-enforceable. Credit risk exposure on derivative financial instruments is represented by the receivable replacement cost of contracts with counterparties, less any prepayment collateral or margin received, as at the reporting date.

The following table provides details of the derivative money market-to-equity swap contracts outstanding as at December 31, 2003.

Notional Principal (000's)	Original Term	Credit Rating of Counterparty	Equity Index	BA Index	Market Value (000's)
$ 18,011	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	$ 715
37,244	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	1,614
56,554	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	2,485
80,257	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	3,479
$ 192,066					$ 8,293
US ($6,000)		Bond Futures			CDN $ 282
Total					$ 8,575

4. Investments and Derivatives (Continued)

Notional amounts of these derivative contracts represent the volume of outstanding transactions and serve as the basis upon which the return from and the market value of the contracts are determined.

Money market-to-equity swap contracts are denominated in Canadian dollars and are reset quarterly.

(c) Market value of investments and related income after allocating the effect of derivative contracts.

	As at December 31, 2003		For the Year	As at December 31, 2002		For the Year
	Assets (000's)	%	Income (Loss) * (000's)	Assets (000's)	%	Income (Loss) * (000's)
Money market	$ 343,644	9.4	$ 5,806	$ 97,419	3.0	$ 1,015
Fixed income	1,096,223	29.9	89,985	1,229,884	38.1	124,021
Equities						
Canadian	1,316,372	36.0	286,580	1,084,296	33.6	(104,321)
US	578,837	15.8	57,160	530,382	16.4	(120,005)
Other foreign	279,114	7.6	25,929	253,346	7.8	(63,321)
Real estate – Canadian	9,356	0.3	301	–	–	–
Real estate – Pooled fund	37,537	1.0	2,468	35,409	1.1	465
Other	–	–	26	–	–	26
	$ 3,661,083	100.0	$ 468,255	$ 3,230,736	100.0	$ (162,120)

* Includes realized losses of $6.6 million (losses of $14.1 million - 2002) and unrealized gains of $327.6 million (unrealized losses of $231.8 million - 2002).

(d) Investment Risk Management

Risk management relates to the understanding and active management of risks associated with all areas of the business and the associated operating environment. Investments are primarily exposed to foreign currency, interest rate volatility, market and credit risk. The Fund has set formal policies and procedures that establish an asset mix among equity, fixed income and real estate investments, require diversification of investments within categories, and set limits on the size of exposure to individual investments and counterparties. In addition, derivative financial instruments are used, where appropriate, to assist in the management of these risks.

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4. Investments and Derivatives (Continued)

(i) Interest rate risk

Interest rate risk refers to the fact that the Plan's financial position will change as market interest rates change. Interest rate risk is inherent in the nature of the pension plan business due to prolonged timing differences between cash flows related to the Plan's assets and cash flows related to the Plan's liabilities.

The value of the Plan's assets is affected by short-term changes in nominal interest rates and equity markets. Pension liabilities are exposed to the long-term expectation of rate of return on the investments as well as expectations of inflation and salary escalation. To meet these liabilities the Plan has established an asset mix policy of approximately 60% equities, 33% fixed income securities and 7% real estate. Long-term equity returns have historically shown high correlation with changes in inflation and salary escalation, while fixed income securities are sensitive to changes in nominal interest rates.

	2003						2002	
	Within 1 year	1 to 5 years	50 to 10 years	Over 10 years	Total	Average effective yield	Total	Average effective yield
	(000's)	(000's)	(000's)	(000's)	(000's)	%	(000's)	%
Money market	$536,195	$ –	$ –	$ –	$ 536,195	2.8	$ 276,780	2.8
Bonds and debentures	43,764	346,559	292,256	298,328	980,907	5.7	1,127,769	5.9
Real return bonds	–	–	–	115,316	115,316	3.8	102,115	4.3
Total	$579,959	$346,559	$292,256	$413,644	$1,632,418		$1,506,664	

The average effective yield reflects the estimated annual income of a security as a percentage of its year-end market value.

4. Investments and Derivatives (Continued)

(ii) 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. The Fund’s policy is to invest in a diversified portfolio of investments, based on criteria established in the Statement of Investment Policies and Guidelines, and to utilize derivative financial instruments, which are designed to mitigate the impact of market risk.

(iii) Credit risk

Credit risk is the risk of loss in the event the counterparty to a transaction fails to discharge an obligation and causes the other party to incur a loss.

The Plan limits credit risk by purchasing fixed income securities with a credit rating of "BBB" and higher. In addition, the Plan limits derivative contract risk by dealing with counterparties that have a minimum "A" credit rating.

(iv) Foreign currency risk

Foreign currency exposure arises from the Plan's holding of equities denominated in foreign currency. From time to time some of this exposure will be hedged based on interest rate spreads or other economic fundamentals.

The Plan's currency exposure from net investment assets as at December 31, 2003 is summarized in the following table:

4. Investments and Derivatives (Continued)

Currency	2003	2002
	(000's)	(000's)
Canada	$ 2,811,380	$ 2,493,795
United States	626,270	566,557
Euro Zone	82,773	66,212
Japan	31,939	26,915
United Kingdom	43,363	57,253
Other	81,359	72,147
Total	$ 3,677,084	$ 3,282,879

5. Actuarial Asset Value Adjustment

The actuarial asset value adjustment is comprised of the present value of future payments under Schedule B of the Act. As at December 31, 2003, no further payments were payable under Schedule B.

6. Actuarial Valuation

Actuarial valuations of the Fund are required every year by the Act, and provide an estimate of the accrued pension benefits (Fund liabilities) calculated using various economic and demographic assumptions, based on membership data as at the valuation date. The Plan's consulting actuaries, William M. Mercer Limited, performed a valuation as at December 31, 2003 and issued their report in May 2004. The report indicated that the Plan had an unfunded liability of $871.2 million (2002 - $1,015.5 million).

The actuarial valuation projects liabilities for each member on the basis of service earned to date and the employee's projected five year average salary at the expected date of retirement. The projected unit credit method was adopted for the actuarial valuation to determine the current cost and actuarial liability. The major economic and demographic assumptions used in the valuation are as follows:

6. Actuarial Valuation (Continued)

	Valuation December 31, 2003	Valuation December 31, 2002
Inflation	3.0% per annum	3.0% per annum
Average Salary Increase	0.5% per annum real plus merit ranging from 0.0% to 2.75% based on 5 year age bands	0.5% per annum real plus merit ranging from 0.0% to 2.75% based on 5 year age bands
Real Rate of Return on Investments	4.25% per annum	4.25% per annum
Average Retirement Age	60% - Retire at earliest date first eligible for an unreduced pension 40% - Retire at the earliest of: - age 65; - 35 years of service; or - age 60 with 10 years of service	60% - Retire at earliest date first eligible for an unreduced pension 40% - Retire at the earliest of: - age 65; - 35 years of service; or - age 60 with 10 years of service
Mortality	1994 Group Annuitant Mortality Table projected to 2000 using scale AA	1994 Group Annuitant Mortality Table projected to 2000 using scale AA

There have been no changes in the major actuarial assumptions and methodology used for the 2003 valuation as compared to the 2002 valuation.

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7. Operating Expenses

The Fund is charged with administrative and certain other expenses incurred on behalf of the Fund by the Department of Finance. The following is a summary of these operating expenses.

	2003	2002
	(000's)	(000's)
Plan Administration		
Professional services	$ 241	$ 150
Salaries	679	681
Supplies and services	357	658
Travel	8	6
Other	103	47
	1,388	1,542
Investment Expenses		
Investment management fees	$ 5,901	$ 5,827
Professional services	33	27
Salaries	360	344
Supplies and services	164	52
Travel	13	22
Other	31	63
	6,502	6,335
Total Operating Expenses	$ 7,890	$ 7,877

8. Related Party Transactions

Investments held in the Fund include debentures of the Province of Nova Scotia with a total market value of $34.9 million (0.9% of total assets) as at December 31, 2003 ($65.3 million (1.9% of total assets) as at December 31, 2002).

9. Comparative Figures

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