

**PROVINCE OF NOVA SCOTIA
NOVA SCOTIA TEACHERS' PENSION FUND
FINANCIAL STATEMENTS
DECEMBER 31, 2001**

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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 Statement of Net Assets Available for Benefits and Accrued Pension Benefits and Deficiency of the **Nova Scotia Teachers= Pension Fund** as at December 31, 2001 and the Statement of Change of Net Assets Available for Benefits 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 net assets available for benefits and accrued pension benefits and deficiency of the Fund as at December 31, 2001 and changes in net assets available for benefits for the year then ended in accordance with Canadian generally accepted accounting principles.



E.R. Salmon, FCA
Auditor General

Halifax, Nova Scotia
September 27, 2002

**PROVINCE OF NOVA SCOTIA
NOVA SCOTIA TEACHERS' PENSION FUND
STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS
AND ACCRUED PENSION BENEFITS AND DEFICIENCY
AS AT DECEMBER 31**

	2001	2000
NET ASSETS AVAILABLE FOR BENEFITS	(in thousands)	
Assets		
Investments (Note 4)	\$ 3,437,725	\$ 3,575,982
Receivable from School Boards (Note 1)	171,430	158,903
Contributions receivable		
Employees=	1,378	941
Employers=	3,907	7,348
Accrued income	19,977	18,963
Cash	<u>1,301</u>	<u>670</u>
 Total assets	 <u>3,635,718</u>	 <u>3,762,807</u>
Liabilities		
Net investment transactions outstanding	16,090	777
Accounts payable	<u>20,910</u>	<u>20,183</u>
Total liabilities	<u>37,000</u>	<u>20,960</u>
 Net assets available for benefits	 3,598,718	 3,741,847
Actuarial asset value adjustment (Note 5)	<u>30,657</u>	<u>44,902</u>
Actuarial value of net assets available for benefits	<u>\$ 3,629,375</u>	<u>\$ 3,786,749</u>
 ACCRUED PENSION BENEFITS AND DEFICIENCY		
Accrued pension benefits	\$ 4,197,692	\$ 3,998,940
Deficiency (Note 6)	<u>(568,317)</u>	<u>(212,191)</u>
Accrued pension benefits and deficiency	<u>\$ 3,629,375</u>	<u>\$ 3,786,749</u>

APPROVED



Minister of Finance

See accompanying notes to financial statements.

**PROVINCE OF NOVA SCOTIA
NOVA SCOTIA TEACHERS' PENSION FUND
STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
FOR THE YEAR ENDED DECEMBER 31**

	2001	2000
	(in thousands)	
Increase In Assets		
Investment activities (Note 4)	\$ -	\$ 263,144
Interest on receivable from School Boards	<u>12,555</u>	<u>13,852</u>
	<u>12,555</u>	<u>276,996</u>
Contributions		
Employers= - matched	50,601	49,083
Employees= - matched	50,601	49,083
Employers= - unmatched - Province	16,798	15,626
Employees= - unmatched	2,617	1,140
Transfers from other pension plans	<u>983</u>	<u>1,639</u>
	<u>121,600</u>	<u>116,571</u>
Total increase in assets	<u>134,155</u>	<u>393,567</u>
Decrease In Assets		
Investment activities (Note 4)	73,008	-
Benefits paid	193,934	186,917
Operating expenses (Note 7)	7,806	7,868
Refund of contributions and interest and transfers to other pension plans	<u>2,536</u>	<u>3,104</u>
Total decrease in assets	<u>277,284</u>	<u>197,889</u>
Increase (Decrease) in Net Assets	(143,129)	195,678
Net Assets Available for Benefits at Beginning of Year	<u>3,741,847</u>	<u>3,546,169</u>
Net Assets Available for Benefits at End of Year	<u>\$ 3,598,718</u>	<u>\$ 3,741,847</u>

See accompanying notes to financial statements.

PROVINCE OF NOVA SCOTIA
NOVA SCOTIA TEACHERS' PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2001

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 formula are also contained in the Act and in the Regulations made under the Act.

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. At December 31, 2001 the balance outstanding was \$171.4 million (December 31, 2000 - \$158.9 million) which is repayable over 8 years and bears interest at 8%. 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
NOVA SCOTIA TEACHERS' PENSION FUND
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2001**

2. Summary of Significant Accounting Policies

(a) Basis of Presentation

These financial statements are prepared on a 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. They are prepared in accordance with Canadian generally accepted accounting principles.

(b) 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 that date. The resulting gain or loss from changes in these rates is included in unrealized investment income.

(c) Investments

- (i) Investments are reported as of the trade date and are stated at market value. 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 unrealized investment income.
- (iii) Investments held in the Fund include debentures of the Province of Nova Scotia and the Nova Scotia Municipal Finance Corporation with total market value of \$65.6 million (1.8% of Total Assets) as at December 31, 2001 (\$103.5 million (2.8% of Total Assets) as at December 31, 2000).

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 assumed responsibility for \$300 million of the unfunded liability. By July 18, 1997 the Province had paid the amount in full.

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3. Agreement to Address Unfunded Liability (Continued)

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.

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, 2001		For the Year	As at December 31, 2000		For the Year
	Assets	%	Income *	Assets	%	Income *
			(Loss)			(Loss)
	(in thousands)					
Money market	\$ 287,494	8.4%	\$ 12,125	\$ 447,933	12.6%	\$ 19,595
Fixed income	1,292,418	37.6%	97,686	1,273,050	35.6%	122,969
Equities - Cdn	922,947	26.8%	(67,482)	1,005,753	28.1%	153,322
- US	617,513	18.0%	(23,168)	479,309	13.4%	9,851
- Other foreign	302,413	8.8%	(64,696)	379,286	10.6%	(77,971)
Derivatives	14,940	0.4%	(27,533)	(9,349)	(0.3)%	35,348
Other	--	0.0%	60	--	0.0%	30
	<u>\$3,437,725</u>	<u>100.0%</u>	<u>\$ (73,008)</u>	<u>\$3,575,982</u>	<u>100.0%</u>	<u>\$ 263,144</u>

* Includes realized losses of \$25.2 million (gains of \$452.4 million - 2000) and unrealized losses of \$122.4 million (losses of \$397.3 million - 2000).

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4. Investments and Derivatives (Continued)

(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.

The following provides details of the derivative money market-to-equity swap contracts outstanding as at December 31, 2001. 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. These contracts are denominated in Canadian dollars and are reset quarterly.

Notional Principal	Original Term	Credit Rating of Counterparty	Equity Index	BA Index	Market Value
(in thousands)					
\$ 16,685	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	\$ 1,230
52,391	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	4,644
74,349	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	6,825
<u>64,363</u>	1.0 yrs	AA(low)	S&P/TSE60	CAD-BA-CDOR	<u>2,241</u>
<u>\$ 207,788</u>					<u>\$ 14,940</u>

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4. Investments and Derivatives (Continued)

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

	<u>As at December 31, 2001</u>		<u>For the Year</u>	<u>As at December 31, 2000</u>		<u>For the Year</u>
	Assets	%	Income * (Loss)	Assets	%	Income * (Loss)
	(in thousands)					
Money market	\$ 73,913	2.1%	\$ 5,319	\$ 215,939	6.0%	\$ 4,148
Fixed income	1,292,418	37.6%	97,686	1,273,050	35.6%	122,969
Equities - Cdn	1,151,468	33.5%	(88,209)	1,228,398	34.4%	204,117
- US	617,513	18.0%	(23,168)	479,309	13.4%	9,851
- Other foreign	302,413	8.8%	(64,696)	379,286	10.6%	(77,971)
Other	-	0.0%	60	-	0.0%	30
	<u>\$ 3,437,725</u>	<u>100.0%</u>	<u>\$ (73,008)</u>	<u>\$ 3,575,982</u>	<u>100.0%</u>	<u>\$ 263,144</u>

* Includes realized losses of \$25.2 million (gains of \$452.4 million - 2000) and unrealized losses of \$122.4 million (losses of \$397.3 million - 2000).

(d) 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 and 40% fixed income securities. 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. At December 31, 2001 the \$1,292.4 million fixed income securities had a modified duration of 5.3 years. This means a 1% decrease in nominal interest rates would increase their market value by approximately 5.3 %.

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4. Investments and Derivatives (Continued)

(5) 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.

(6) Foreign currency risk

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

The Plan's foreign currency exposure as at December 31, 2001 is summarized in the following table.

Currency	2001	2000
	(in thousands)	
Canada	\$ 2,517,303	\$ 2,724,987
Eurozone	85,310	162,538
Japan	36,204	26,438
United Kingdom	54,293	52,107
United States	672,110	515,870
Other	<u>93,783</u>	<u>113,675</u>
Total	<u>\$ 3,459,003</u>	<u>\$ 3,595,615</u>

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, 2001, the present value of these future payments was \$30.7 million (2000: \$44.9 million).

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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 Plans consulting actuaries, William M. Mercer Limited performed a valuation as at December 31, 2001 and issued their report in August 2002. The report indicated that the Plan had an unfunded liability of \$568.3 million (2000 - \$212.2 million).

The actuarial valuation projects liabilities for each member on the basis of service earned to date and the employees 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:

	Valuation December 31, 2001	Valuation December 31, 2000
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; or - 35 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

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6. Actuarial Valuation (continued)

The impact of the change in major actuarial assumptions and methodology used for the 2001 valuation as compared to the 2000 valuation:

- The average retirement age assumption was changed to 60% of members retire at earliest date first eligible for an unreduced pension with the remainder retiring at the earliest of age 65 or with 35 years of service or age 60 with 10 years of service, from 60% of members retire at earliest date for an unreduced pension or at the earliest of age 65 or with 35 years of service. This change increased Plan liabilities by \$50.6 million.
- The accrual of future service for each member was changed, to being based on the percentage of full-time service in the valuation year from being based on a full year of service. This change decreased Plan liabilities by \$10.4 million.

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.

	<u>2001</u>	<u>2000</u>
	(in thousands)	
Plan Administration		
Professional services	\$ 136	\$ 140
Salaries	562	448
Supplies and services	378	473
Travel	7	6
Other	<u>88</u>	<u>64</u>
	<u>\$ 1,171</u>	<u>\$ 1,131</u>
Investment Expenses		
Investment management fees	\$ 6,219	\$ 6,302
Professional services	83	11
Salaries	265	302
Supplies and services	24	47
Travel	21	21
Other	<u>23</u>	<u>54</u>
	<u>\$ 6,635</u>	<u>\$ 6,737</u>
Total Operating Expenses	<u>\$ 7,806</u>	<u>\$ 7,868</u>

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8. Comparative Figures

Certain comparative figures have been reclassified to conform with the financial statement presentation for this year.