

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

Financial Statements YEAR ENDED MARCH 31, 2005

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AUDITOR'S REPORT

To the Minister of Finance

I have audited the balance sheet of the Alberta Heritage Foundation for Medical Research Endowment Fund as at March 31, 2005 and the statements of income and retained earnings and cash flows 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 financial position of the Fund as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Alberta
May 20, 2005

[Original Signed]
Fred J. Dunn, FCA
Auditor General

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

BALANCE SHEET

March 31, 2005 (*thousands*)

	2005	2004
Assets		
Portfolio investments (Note 3)	\$ 871,419	\$ 848,503
Administration expense receivable	22	26
	<u>\$ 871,441</u>	<u>\$ 848,529</u>
Endowment and Retained Earnings		
Endowment (Note 6)	\$ 300,000	\$ 300,000
Retained earnings (Note 6)	571,441	548,529
	<u>\$ 871,441</u>	<u>\$ 848,529</u>

STATEMENT OF INCOME AND RETAINED EARNINGS

Year Ended March 31, 2005 (*thousands*)

	Budget	2005 Actual	2004 Actual
Income			
Net investment income (Note 7)	\$ 29,721	\$ 72,912	\$ 72,368
Expenses			
Transfers to the Alberta Heritage Foundation for Medical Research	55,000	50,000	50,000
Net income (loss)	<u>\$ (25,279)</u>	22,912	22,368
Retained earnings at beginning of year		548,529	526,161
Retained earnings at end of year		<u>\$ 571,441</u>	<u>\$ 548,529</u>

The accompanying notes and schedules are part of these financial statements.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

STATEMENT OF CASH FLOWS

Year Ended March 31, 2005 (*thousands*)

	2005	2004
Operating transactions		
Net income	\$ 22,912	\$ 22,368
Non-cash items included in net income	(9,751)	(4,905)
	<u>13,161</u>	<u>17,463</u>
Decrease in receivables	4	564
Decrease in payables	-	(5)
Cash provided by operating transactions	<u>13,165</u>	<u>18,022</u>
Investing transactions		
Proceeds from disposals, repayments and redemptions of investments	216,060	103,394
Purchase of investments	(220,332)	(125,024)
Cash applied to investing transactions	<u>(4,272)</u>	<u>(21,630)</u>
Increase (decrease) in cash	8,893	(3,608)
Cash at beginning of year	8,739	12,347
Cash at end of year	<u>\$ 17,632</u>	<u>\$ 8,739</u>
Consisting of Deposit in the Consolidated Cash Investment Trust Fund (Note 3)	<u>\$ 17,632</u>	<u>\$ 8,739</u>

The accompanying notes and schedules are part of these financial statements.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTES TO THE FINANCIAL STATEMENTS

March 31, 2005 (*thousands*)

NOTE 1 AUTHORITY AND PURPOSE

The Alberta Heritage Foundation for Medical Research Endowment Fund ("the Fund") operates under the authority of the *Alberta Heritage Foundation for Medical Research Act*, Chapter A-21, Revised Statutes of Alberta 2000.

The purpose of the Fund is to invest the endowment made to the Fund. The Fund is managed with the objectives of providing an annual level of income for transfer to the Alberta Heritage Foundation for Medical Research while preserving the capital of the endowment over the long term. The portfolio is comprised of high quality fixed-income securities, equities, real estate, absolute return strategy investments and derivative financial instruments.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

The recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants are the primary source for the disclosed basis of accounting. Recommendations of the Accounting Standards Board of the Canadian Institute of Chartered Accountants, other authoritative pronouncements, accounting literature, published financial statements relating to either the public sector or analogous situations in the private sector are used to supplement the recommendations of the Public Sector Accounting Board where it is considered appropriate.

The accounting policies of significance to the Fund are as follows:

a) Portfolio investments

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

b) Investment Income

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 2 (continued)

Gains and losses arising as a result of disposals of investments are included in the determination of investment income.

Income and expense from derivative contracts are included in investment income. Certain derivative contracts, which are primarily interest rate swaps and cross-currency interest rate swaps, are designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same period as the gains and losses of the security being hedged. As a result, income and expense from derivative contracts designated as hedges are recognized in income on an accrual basis with gains and losses recognized in income to the extent realized.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge.

Derivative contracts not designated as hedges for purposes of hedge accounting, which are primarily bond index swaps, equity index swaps, equity index futures contracts, forward foreign exchange contracts and credit default swap contracts, are recorded at fair value.

c) Foreign Currency

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

d) Investment Valuation

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3 and Schedules A to E.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Measurement uncertainty exists in the fair values reported for certain investments such as private equities, private real estate, absolute return strategies and other private placements. The fair value of these investments are based on estimates where quoted market prices are not readily available. Estimated fair values may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

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NOTE 2 (continued)

Fair values of investments held either directly by the Fund or by pooled investment funds are determined as follows:

- (i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.
- (ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
- (iii) The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and multiple analysis.
- (iv) The fair value of real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including the replacement cost, direct comparison, direct capitalization of earnings and discounted cash flows.
- (v) The fair value of absolute return strategy investments are estimated by external managers.
- (vi) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.
- (vii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

e) Valuation of Derivative Contracts

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts and equity index futures contracts. As disclosed in Note 5, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

- (i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.
- (ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
- (iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
- (iv) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 3 PORTFOLIO INVESTMENTS (Schedules A to E)

(thousands)

	2005			2004		
	Cost	Fair Value	%	Cost	Fair Value	%
Fixed-Income Securities (Schedule A)						
Deposit in the Consolidated Cash						
Investment Trust Fund (a)	\$ 17,632	\$ 17,632	1.9	\$ 8,739	\$ 8,739	1.0
Canadian Dollar Public Bond Pool (b)	192,726	195,135	21.4	197,301	201,362	22.4
Private Mortgage Pool (c)	29,681	32,935	3.6	30,267	33,837	3.8
Overlay Pool (d)	1,820	1,822	0.2	-	-	-
	241,859	247,524	27.1	236,307	243,938	27.2
Canadian Equities (Schedule B)						
Domestic Passive Equity Pooled Fund (e)	76,956	76,821	8.4	97,158	97,110	10.8
Canadian Pooled Equity Fund (f)	38,735	46,282	5.1	50,693	58,917	6.6
External Managers:						
Canadian Equity Enhanced Index Pool (g)	24,741	27,077	3.0	-	-	-
Canadian Large Cap Pool (h)	12,385	13,627	1.5	51,900	59,112	6.6
Canadian Small Cap Pool	-	-	-	3,274	4,469	0.5
Growing Equity Income Pool (i)	10,878	12,931	1.4	15,106	15,839	1.8
Canadian Multi-Cap Pool (j)	11,456	11,465	1.3	-	-	-
	175,151	188,203	20.7	218,131	235,447	26.3
Overlay Pool Canadian futures contracts (d)	(9,300)	(9,300)	(1.0)	-	-	-
	165,851	178,903	19.7	218,131	235,447	26.3
United States Equities (Schedule C)						
S&P 500 Index Fund (k)	114,362	115,415	12.7	74,100	75,931	8.5
External Managers:						
US Large Cap Equity Pool	9	9	-	56,944	56,892	6.3
US Small/Mid Cap Equity Pool (l)	19,392	20,330	2.2	16,026	18,370	2.0
Portable Alpha United States Equity Pool (m)	25,408	24,708	2.7	-	-	-
Growing Equity Income Pool (i)	2,074	2,060	0.2	-	-	-
	161,245	162,522	17.8	147,070	151,193	16.8
Overlay Pool US futures contracts (d)	9,349	9,349	1.0	-	-	-
	170,594	171,871	18.8	147,070	151,193	16.8
Non-North American Equities (Schedule D)						
External Managers:						
EAFE Core Equity Pool (n)	87,687	87,044	9.5	78,090	79,261	8.8
EAFE Plus Equity Pool (n)	43,936	44,076	4.8	37,085	39,292	4.4
EAFE Passive Equity Pool (o)	27,817	34,351	3.8	32,512	41,746	4.6
Emerging Market Equity Pool (p)	9,257	10,185	1.1	-	-	-
	168,697	175,656	19.2	147,687	160,299	17.8
Real Estate (Schedule E)						
Private Real Estate Pool (q)	66,365	80,152	8.8	58,197	64,758	7.2
Foreign Private Real Estate Pool (r)	3,162	3,000	0.3	-	-	-
	69,527	83,152	9.1	58,197	64,758	7.2
Absolute Return Strategies						
External Managers:						
Absolute Return Strategy Pool (s)	44,279	43,906	4.8	36,819	36,453	4.1
Private Equity and Income (t)						
Private Equity Pools	6,395	6,963	0.8	4,292	5,116	0.6
Private Income Pool	4,217	4,154	0.5	-	-	-
	10,612	11,117	1.3	4,292	5,116	0.6
Total Investments (u)	\$ 871,419	\$ 912,129	100.0	\$ 848,503	\$ 897,204	100.0

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NOTE 3 (continued)

The Fund's investments are held in pooled investment funds established and administered by Alberta Finance. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2005, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

	% Ownership	
	2005	2004
Internally Managed Investment Pools		
Canadian Dollar Public Bond Pool	2.2	2.4
Canadian Multi-Cap Pool	5.0	-
Canadian Pooled Equity Fund	4.3	5.7
Domestic Passive Equity Pooled Fund	3.2	4.1
Foreign Private Equity Pool (02)	3.5	3.5
Foreign Private Real Estate Pool	6.4	-
Growing Equity Income Pool	5.0	6.2
Overlay Pool	2.6	-
Private Equity Pool	6.6	6.6
Private Equity Pool (02)	5.2	5.3
Private Equity Pool (04)	5.5	-
Private Income Pool	1.8	2.6
Private Mortgage Pool	2.7	2.8
Private Real Estate Pool	2.8	2.9
Standard & Poor's 500 Index Fund	6.2	6.0
Portable Alpha United States Equity Pool	6.9	-
Externally Managed Investment Pools		
Absolute Return Strategy Pool	6.4	6.4
Canadian Equity Enhanced Equity Pool	5.1	-
Canadian Large Cap Equity Pool	0.6	1.9
Canadian Small Cap Equity Pool	-	0.7
EAFE Core Equity Pool	2.8	2.6
EAFE Passive Equity Pool	7.5	6.2
EAFE Plus Equity Pool	2.9	2.6
Emerging Markets Equity Pool	2.4	-
US Large Cap Equity Pool	-	2.9
US Small/Mid Cap Equity Pool	2.2	2.7

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 3 (continued)

- (a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2005, securities held by the Fund have an average effective market yield of 2.79% per annum (2004: 2.11% per annum).
- (b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2005, securities held by the Pool have an average effective market yield of 4.48% per annum (2004: 4.20% per annum) and the following term structure based on principal amount: under 1 year: 3% (2004: 2%); 1 to 5 years: 38% (2004: 40%); 5 to 10 years: 31% (2004: 30%); 10 to 20 years: 12% (2004: 10%); and over 20 years: 16% (2004: 18%).
- (c) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2005, securities held by the Pool have an average effective market yield of 5.29% per annum (2004: 5.50% per annum) and the following term structure based on principal amount: under 1 year: 2% (2004: 7%); 1 to 5 years: 22% (2004: 23%); 5 to 10 years: 43% (2004: 26%); 10 to 20 years: 12% (2004: 20%); and over 20 years: 21% (2004: 24%).
- (d) The Overlay Pool provides participants with a quick, effective and efficient means to achieve tactical asset allocation opportunities without incurring undue transaction costs in the underlying investments. Long or short exposures to respective asset classes are obtained through synthetic instruments on a largely unfunded basis using equity index futures contracts. Approximately 5% to 10% of the Pool's notional exposure in Canadian and US futures contracts is supported by cash and short-term securities. The Overlay Pool is comprised of the "long" position through US futures contracts, the "short" position through Canadian futures contracts, and the "cash securities" position through money market securities. Taken together these three positions reduce exposure to Canadian equities and increase exposure to US equities.
- (e) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of publicly traded Canadian equities and structured investments replicating the S&P/TSX 60 Index. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of five years or less.
- (f) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Composite Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection, while remaining sector neutral.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 3 (continued)

- (g) The externally managed Canadian Equity Enhanced Index Pool allows participants the opportunity to gain investment exposure to the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year moving average period. The portfolio is comprised of publicly traded equities in Canadian corporations. The enhanced index generates a consistent level of return above the Index with relatively low risk.
- (h) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX Composite Index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.
- (i) The Growing Equity Income Pool is managed with the objective of providing a steady and growing stream of dividend income to client portfolios by investing in mature companies with strong financial characteristics and growing distributions. Risk is reduced by holding established, well capitalized companies. The performance of the pool is measured against the total return of a custom S&P/TSX Composite Index for dividend paying stocks.
- (j) The Canadian Multi-Cap Pool allows participants to gain investment exposure to the Canadian equity market through internally managed structured investments replicating the S&P/TSX 60 Index and external actively managed Canadian small and mid cap investments. The performance of the pool is measured against the total return of the S&P/TSX Composite Index over a four-year moving average period.
- (k) Publicly traded US equities held in the S&P 500 Index Fund replicate the Standard & Poor's (S&P) 500 index. The performance objective is to provide returns comparable to the total return of the S&P 500 index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3(e)).
- (l) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 Index over a four-year period.
- (m) The Portable Alpha United States Equity Pool consists of futures and swap contracts which provide exposure to the U.S. equity market by replicating the S&P 500 Index and investments in value added absolute return strategies. The performance objective is to provide returns higher than the total return of the Standard & Poor's (S&P) 500 Index over a four-year period.
- (n) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 3 (continued)

- (o) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicate the MSCI EAFE index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE Index over a four-year period.
- (p) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolio is actively managed by external managers with expertise in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital Index Emerging Markets Free (MSCI EMF) Index over a four-year period.
- (q) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary companies which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.
- (r) The Foreign Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5.0%. The Pool provides diverse exposure to non-domestic real estate by investing in foreign real estate backed securities and assets.
- (s) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6.0%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.
- (t) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02, PEP04, the Foreign Private Equity Pool 2002 and the Private Income Pool. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool. The Private Income Pool allows unit holders to participate as equity investors in infrastructure related projects that are structured to yield high current income with the objective of providing investment returns higher than the CPI plus 6.0%
- (u) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and are temporary in nature.

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NOTE 4 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

In order to earn an optimal financial return at an acceptable level of risk, management of the Fund established the following long-term policy asset mix for the 2004-2005 fiscal year:

Fixed-income securities	30% to 20%
Equities	70% to 80%

Risk is reduced through asset class diversification, diversification within each asset class, quality constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 5). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 5).

NOTE 5 DERIVATIVE CONTRACTS

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

- (i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. A credit default swap allows counter-parties to buy and sell protection on credit risk inherent in a bond. A premium is paid, based on a notional amount, from one counter party to a second counter party in exchange for a contingent payment should a defined credit event occur with respect to the underlying security. There are underlying securities supporting all swaps. Leveraging is not allowed.
- (ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.
- (iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

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NOTE 5 (continued)

The following is a summary of the Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2005.

(thousands)

	Maturity			2005		2004	
	Under 1 Year	1 to 3 Years	Over 3 Years	Notional Amount (a)	Fair Value (b)	Notional Amount (a)	Fair Value (b)
Equity index swap contracts	66%	34%	-	\$ 125,496	\$ 508	\$ 90,928	\$ (631)
Forward foreign exchange contracts	100%	-	-	69,421	946	42,946	352
Interest rate swap contracts	38%	49%	13%	40,354	(1,015)	55,590	(2,473)
Cross-currency interest rate swaps	8%	33%	59%	42,907	520	27,604	(2,869)
Credit default swap contracts	33%	11%	56%	10,252	106	3,724	(31)
Equity index futures contracts	100%	-	-	22,795	471	663	72
Bond index swap contracts	100%	-	-	3,793	26	2,849	70
				<u>\$ 315,018</u>	<u>\$ 1,562</u>	<u>\$ 224,304</u>	<u>\$ (5,510)</u>

(a) The notional amounts, upon which payments are based, are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value). The Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

(b) The method of determining the fair value of derivative contracts is described in Note 2 (e).

NOTE 6 ENDOWMENT AND RETAINED EARNINGS

The endowment was received from the Alberta Heritage Savings Trust Fund on March 31, 1980. The Alberta Heritage Foundation for Medical Research Act provides that money required by the Foundation for the furtherance of its objectives shall be paid from the Fund, but no money shall be paid out of the Fund if the payment would result in the value of the assets of the Fund, at cost, being less than the endowment received by the Fund.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 7 NET INVESTMENT INCOME (LOSS)*(thousands)*

	2005	2004
Deposits and fixed-income securities	\$ 14,806	\$ 17,351
Canadian equities	32,336	34,638
United States equities	(228)	2,985
Non-North American equities	18,448	9,892
Real estate	4,832	3,721
Absolute return strategies	2,308	2,713
Private equities and income	595	1,225
Investment income	73,097	72,525
Direct administrative expenses (Note 8)	(185)	(157)
Net investment income	\$ 72,912	\$ 72,368

Investment income is comprised of interest, dividends, amortization of discount or premium, swap income, security lending income and realized gains and losses, net of write-downs on investments. The Fund's share of income (loss) earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools (see Note 8).

The investment income for the year ended March 31, 2005 includes writedowns of \$2,022 (2004: \$245).

NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expenses include investment management, cash management and safekeeping costs and other expenses charged on a cost-recovery basis directly by Alberta Finance. The Fund's total administrative expenses for the period, including amounts deducted directly from investment income of pooled investment funds is as follows:

	2005	2004
Direct fund expenses (Note 7)	\$ 185	\$ 157
Externally managed investment pools	1,240	922
Internally managed investment pools	258	232
	\$ 1,683	\$ 1,311
Expenses as a percentage of net assets at fair value	0.185%	0.146%

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

NOTE 9 INVESTMENT PERFORMANCE

The following is a summary of the investment performance results attained by the Fund determined on a fair value basis:

	One Year Return	Five Year Compound Annualized Return
Time-weighted rates of return		
Overall actual return	7.5%	1.4%
Benchmark return*	6.0%	1.0%

*The overall benchmark return for year ended March 31, 2005 is a product of the weighted average policy sector weights and the sector benchmark returns.

NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Finance.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES**Schedule A**March 31, 2005 (*thousands*)

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Deposits and short-term securities	\$ 19,780	\$ 19,780	\$ 9,058	\$ 9,058
Fixed-income securities (a)				
Corporate, public and private	115,260	117,858	130,390	134,320
Government of Canada, direct and guaranteed	58,545	58,591	47,786	47,980
Provincial, direct and guaranteed:				
Alberta	111	119	136	149
Other provinces	44,236	47,133	46,649	50,025
Municipal	2,358	2,474	2,617	2,735
	<u>220,510</u>	<u>226,175</u>	<u>227,578</u>	<u>235,209</u>
Receivable from sale of investments and accrued investment income	2,700	2,700	2,523	2,523
Accounts payable and accrued liabilities	(1,131)	(1,131)	(2,852)	(2,852)
	<u>1,569</u>	<u>1,569</u>	<u>(329)</u>	<u>(329)</u>
	<u>\$ 241,859</u>	<u>\$ 247,524</u>	<u>\$ 236,307</u>	<u>\$ 243,938</u>

(a) Fixed income securities held as at March 31, 2005 have an average effective market yield of 4.59% per annum (2004: 4.39% per annum) and the following term structure based on principal amount:

	2005	2004
	%	%
under 1 year	3	3
1 to 5 years	35	37
5 to 10 years	33	30
10 to 20 years	12	11
over 20 years	17	19
	<u>100</u>	<u>100</u>

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES**Schedule B**March 31, 2005 (*thousands*)

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Deposits and short-term securities	\$ 1,347	\$ 1,347	\$ 1,697	\$ 1,697
Public equities (a) (b)				
Consumer discretionary	11,821	11,216	17,710	16,705
Consumer staples	6,987	7,754	8,751	9,431
Energy	29,885	36,319	29,005	34,413
Financials	52,983	57,366	68,423	76,603
Health care	2,890	2,379	5,168	4,841
Industrials	8,722	9,649	17,325	17,899
Information technology	10,115	9,565	15,472	17,388
Materials	24,136	25,539	36,023	38,450
Telecommunication services	10,245	10,854	11,947	11,147
Utilities	2,301	2,454	8,211	8,478
	160,085	173,095	218,035	235,355
Small Cap Pooled Fund	3,446	3,488	56	52
Receivable from sale of investments and accrued investment income	2,976	2,976	926	926
Accounts payable and accrued liabilities	(2,003)	(2,003)	(2,583)	(2,583)
	973	973	(1,657)	(1,657)
	\$ 165,851	\$ 178,903	\$ 218,131	\$ 235,447

(a) The Fund's effective net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling \$70,480 (2004: \$68,220).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES**Schedule C**March 31, 2005 (*thousands*)

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Deposits and short-term securities	\$ 2,440	\$ 2,440	\$ 2,300	\$ 2,300
Public equities (a) (b)				
Consumer discretionary	19,591	20,167	23,443	24,305
Consumer staples	16,241	15,965	14,297	14,116
Energy	13,546	14,808	8,698	8,696
Financials	34,925	34,373	28,828	30,775
Health care	22,541	22,055	19,428	18,283
Industrials	20,864	21,408	16,424	17,042
Information technology	25,957	25,746	22,595	23,998
Materials	6,373	6,706	4,752	5,523
Telecommunication services	4,849	4,680	4,488	4,256
Utilities	5,835	6,091	3,478	3,560
	170,722	171,999	146,431	150,554
Receivable from sale of investments and accrued investment income	1,337	1,337	573	573
Accounts payable and accrued liabilities	(3,905)	(3,905)	(2,234)	(2,234)
	(2,568)	(2,568)	(1,661)	(1,661)
	\$ 170,594	\$ 171,871	\$ 147,070	\$ 151,193

(a) The Fund's effective net investment in US public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling \$77,811 (2004: \$23,371).

(b) The sector classification conforms to the Global Industry Classification Standard followed by the Standard & Poor's (S&P) 500 Index.

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES

Schedule D

March 31, 2005 (*thousands*)

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Deposits and short-term securities	\$ 3,308	\$ 3,308	\$ 3,152	\$ 3,152
Public equities (a)				
Consumer discretionary	22,447	22,620	22,142	24,517
Consumer staples	9,724	9,874	11,281	11,739
Energy	13,622	14,829	11,718	12,026
Financials	41,421	44,639	33,732	37,879
Health care	10,762	10,287	12,616	12,220
Industrials	19,015	20,380	16,413	18,115
Information technology	8,752	8,562	8,154	9,792
Materials	13,538	14,808	10,813	12,171
Telecommunication services	14,722	14,420	11,864	12,368
Utilities	7,080	7,389	5,645	6,163
	161,083	167,808	144,378	156,990
Emerging markets pooled funds	4,000	4,234	-	-
Receivable from sale of investments and accrued investment income	2,124	2,124	1,670	1,670
Accounts payable and accrued liabilities	(1,818)	(1,818)	(1,513)	(1,513)
	306	306	157	157
	\$ 168,697	\$ 175,656	\$ 147,687	\$ 160,299

a) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. Public equities by geographic location are as follows:

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
United Kingdom	\$ 36,152	\$ 36,354	\$ 35,184	\$ 36,158
Japan	29,994	29,004	26,583	30,192
France	15,505	16,582	13,638	14,671
Germany	11,375	11,902	9,885	10,656
Switzerland	10,174	10,588	11,823	12,317
Netherlands	8,799	9,061	8,226	8,518
Australia	6,436	7,584	6,166	7,647
Italy	5,684	6,458	6,435	6,906
Spain	4,483	4,895	3,698	4,185
Sweden	4,154	4,476	2,520	2,932
Other	28,327	30,904	20,220	22,808
	\$ 161,083	\$ 167,808	\$ 144,378	\$ 156,990

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENTS IN REAL ESTATE

Schedule E

March 31, 2005 (thousands)

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Deposits and short-term securities	\$ 33	\$ 33	\$ 79	\$ 79
Real estate (a)				
Office	31,149	36,450	24,685	28,809
Retail	24,783	32,457	25,268	27,428
Industrial	5,444	6,332	3,836	4,316
Residential	3,694	3,618	3,597	3,394
	65,070	78,857	57,386	63,947
Foreign Private Real Estate Pool	3,162	3,000	-	-
Participation units	1,156	1,156	570	570
Accrued income and accounts receivable	106	106	162	162
	\$ 69,527	\$ 83,152	\$ 58,197	\$ 64,758

a) The following is a summary of real estate investments by geographic location:

	Fund's share 2005		Fund's share 2004	
	Cost	Fair Value	Cost	Fair Value
Ontario	\$ 41,651	\$ 52,477	\$ 42,410	\$ 47,305
Alberta	13,209	16,373	13,750	15,318
Quebec	8,657	8,295	-	-
British Columbia	1,553	1,712	1,226	1,324
	\$ 65,070	\$ 78,857	\$ 57,386	\$ 63,947

ALBERTA HERITAGE FOUNDATION FOR MEDICAL RESEARCH ENDOWMENT FUND

SCHEDULE OF INVESTMENT RETURNS**Schedule F**

Year Ended March 31, 2005

The Fund uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Time-weighted Rates of Return	2005	One Year Return				5 Year Compound Annualized Return
		2004	2003	2002	2001	
Short-term fixed income	2.3	3.0	2.7	3.9	5.9	3.6
<i>Scotia Capital 91-day T-Bill Index</i>	2.2	3.0	2.7	3.7	5.7	3.5
Long-term fixed income	5.6	11.6	9.6	5.9	9.3	8.4
<i>Scotia Capital Universe Bond Index</i>	5.0	10.8	9.2	5.1	8.7	7.7
Canadian equities	15.4	36.3	(17.4)	3.7	(16.5)	2.4
<i>S&P/TSX Composite Index</i>	13.9	37.7	(17.6)	4.9	(18.6)	2.0
United States equities	(1.7)	22.2	(30.5)	1.6	(14.4)	(6.2)
<i>S&P 1500 Index</i>	(1.0)	20.5	(30.7)	1.6	(15.1)	(6.5)
Non-North American equities	7.4	40.9	(29.1)	(5.8)	(23.2)	(4.9)
<i>MSCI EAFE Index</i>	6.2	40.5	(29.3)	(7.3)	(19.6)	(4.7)
Real estate	16.9	7.5	9.8	7.2	9.7	10.2
<i>Consumer Price Index (CPI) plus 5%</i>	7.1	5.7	8.9	9.9	11.9	8.7
Absolute return strategies	5.5	10.7	1.6	n/a	n/a	n/a
<i>Consumer Price Index (CPI) plus 6%</i>	8.1	6.7	4.7	n/a	n/a	n/a
Private equities	(0.9)	1.1	(3.3)	n/a	n/a	n/a
<i>Consumer Price Index (CPI) plus 8%</i>	10.1	8.7	5.7	n/a	n/a	n/a
Private income	5.3	n/a	n/a	n/a	n/a	n/a
<i>Consumer Price Index (CPI) plus 6%</i>	8.1	n/a	n/a	n/a	n/a	n/a
Overall	7.5	24.0	(13.4)	2.4	(9.2)	1.4
<i>Policy Benchmark</i>	6.0	23.3	(13.7)	2.7	(9.5)	1.0