

ALBERTA REVENUE ANNUAL REPORT

FOR THE FISCAL YEAR ENDED MARCH 31, 2003 | PUBLISHED SEPTEMBER 2003

2003

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PREFACE

Public Accounts 2002-03

The Public Accounts of Alberta are prepared in accordance with the *Financial Administration Act* and the *Government Accountability Act*. The Public Accounts consist of the annual report of the Government of Alberta and the annual reports of each of the 24 Ministries.

The annual report of the Government of Alberta released June 24, 2003 contains the Minister of Finance's accountability statement, the consolidated financial statements of the Province and a comparison of the actual performance results to desired results set out in the government's business plan, including the *Measuring Up* report.

This annual report of the Ministry of Revenue contains the Minister's accountability statement, the audited consolidated financial statements of the Ministry and a comparison of actual performance results to desired results set out in the ministry business plan. This Ministry annual report also includes:

- the financial statements of entities making up the Ministry including the Department of Revenue, regulated funds and provincial agencies for which the Minister is responsible, and
- other financial information as required by the *Financial Administration Act* and *Government Accountability Act*, either as separate reports or as a part of the financial statements, to the extent that the Ministry has anything to report.

MINISTER'S ACCOUNTABILITY STATEMENT

The Ministry's Annual Report for the year ended March 31, 2003, was prepared under my direction in accordance with the *Government Accountability Act* and the government's accounting policies. All of the government's policy decisions as at September 5, 2003, with material economic or fiscal implications of which I am aware have been considered in the preparation of this report.

[original signed]

Honourable Greg Melchin, CA
Minister of Revenue

MESSAGE FROM THE MINISTER

It is a pleasure to present the second Annual Report for the Ministry of Revenue. Our ministry has been very busy since Alberta Treasury was split into Finance and Revenue in 2001. Yet, we have risen to meet the challenges and we have continued in our quest to take a long-term strategic look at collecting revenues and investing provincial assets.

As the provincial government's investment arm, Revenue has been challenged to manage approximately \$34 billion of assets through the worst bear market since the 1930s. Investor confidence has been shaken by corporate scandals in the United States and by severe, worldwide market corrections. Through it all, the impact on provincial investments, including the Alberta Heritage Savings Trust Fund, has been mitigated because investment strategies include diversified, balanced portfolios that have weathered the storm. As markets improve, provincial investments will rebound.

From a policy standpoint, provincial savings policies were explored and Albertans were given an opportunity to share their thoughts on the Heritage Fund's future. Over 77,000 participated in a province-wide survey, reaffirming their commitment to the Heritage Fund and to holding long-term savings. Over the next year, government will explore ways to strengthen the Heritage Fund as an endowment fund and to protect its value over the long term.

A competitive tax structure is essential to the province's long-term economic growth and ensures Albertans can enjoy a high quality of life. In keeping with our promise to businesses, reductions to business taxes continued. The general corporate tax rate was reduced to 13 per cent, the small business rate to 4.5 per cent, and the small business exemption increased to \$350,000. Businesses saved over \$81 million in taxes in 2002-03 adding to the \$286 million that has been cut since 2001.

Government increased tobacco taxes for the first time in 10 years, bringing in a tobacco tax increase of over 125 per cent. This supported the province's tobacco reduction strategy and efforts to significantly reduce smoking, especially among youth. While it is difficult to measure the number of smokers who quit, tax-paid tobacco sales dropped by 18 per cent over the year.

As the province managed volatility in resource revenues and developed a new fiscal framework, Revenue continued to take a long-term, strategic look at revenue policies and practices. Work on a Revenue Management Framework continued. Reviews of tax policies also continued as Alberta strives to maintain a broad-based, low rate tax structure that is competitive on the global stage.

This year, Alberta took a leadership role in reforming securities regulation. Over the years many regulators, industry representatives and legal practitioners have suggested ways the securities system in Canada can be improved. Reducing the number of barriers faced by issuers and registrants wishing to operate in more than one jurisdiction, as well as improving investor protection, will greatly benefit the securities environment. Recognizing the importance of these issues, provincial and territorial ministers from across the country have agreed to work together to identify improvements that will inspire investor confidence and create a more efficient, streamlined and effective securities regulatory system. Alberta is proud to chair this initiative, with work continuing quickly, as the Ministers have committed to develop an action plan by the fall of 2003.

Finally, Alberta Revenue is fortunate to have dedicated professional staff. I thank you for your commitment to excellence, for serving all Albertans well, and ensuring revenue policies reflect Albertans' values now and into the future.

[original signed]

Honourable Greg Melchin, CA
Minister of Revenue

MANAGEMENT'S RESPONSIBILITY FOR REPORTING

The Ministry of Revenue includes:

- ***Department of Revenue***

- ***Alberta Heritage Savings Trust Fund***

- ***Alberta Heritage Foundation for Medical Research Endowment Fund***

- ***Alberta Heritage Scholarship Fund***

- ***Alberta Heritage Science and Engineering Research Endowment Fund***

- ***Alberta Risk Management Fund***

- ***Alberta Securities Commission***

The executives of the individual entities within the Ministry have the primary responsibility and accountability for the respective entities. Collectively, the executives ensure the Ministry complies with all relevant legislation, regulations and policies.

Ministry business plans, annual reports, performance results and the supporting management information are integral to the government's fiscal and business plans, annual report, quarterly reports and other financial and performance reporting.

Responsibility for the integrity and objectivity of the consolidated financial statements and performance results for the Ministry rests with the Minister of Revenue. Under the direction of the Minister, I oversee the preparation of the Ministry's annual report, including consolidated financial statements and performance results. The consolidated financial statements and the performance results, of necessity, include amounts that are based on estimates and judgments. The consolidated financial statements are prepared in accordance with the government's stated accounting policies.

As Deputy Minister, in addition to program responsibilities, I establish and maintain the Ministry's financial administration and reporting functions. The Ministry maintains systems of financial management and internal control which give consideration to costs, benefits, and risks that are designed to:

- provide reasonable assurance that transactions are properly authorized, executed in accordance with prescribed legislation and regulations, and properly recorded so as to maintain accountability of public money,
- provide information to manage and report on performance,
- safeguard the assets and properties of the Province under Ministry administration,
- provide Executive Council, Treasury Board, the Minister of Finance and the Minister of Revenue any information needed to fulfill their responsibilities, and
- facilitate preparation of Ministry business plans and annual reports required under the *Government Accountability Act*.

In fulfilling my responsibilities for the Ministry, I have relied, as necessary, on the executives of the individual entities within the Ministry.

[original signed]

Robert Bhatia
Deputy Minister
September 5, 2003

OVERVIEW

2003

- **MINISTRY VISION, MISSION AND CORE BUSINESSES**
- **RELATIONSHIP OF REVENUE DEPARTMENT AND REPORTING ENTITIES TO CORE BUSINESSES**
- **OPERATIONAL OVERVIEW**
- **SUMMARY OF KEY ACTIVITIES IN THE PAST YEAR**
- **LEGISLATION ADMINISTERED BY ALBERTA REVENUE**

MINISTRY VISION, MISSION AND CORE BUSINESSES

Our vision of the future

“A province where government revenue policy and administration reflect the values of Albertans, balance present and future needs and contribute to a stable environment for the generation of wealth for all Albertans.”

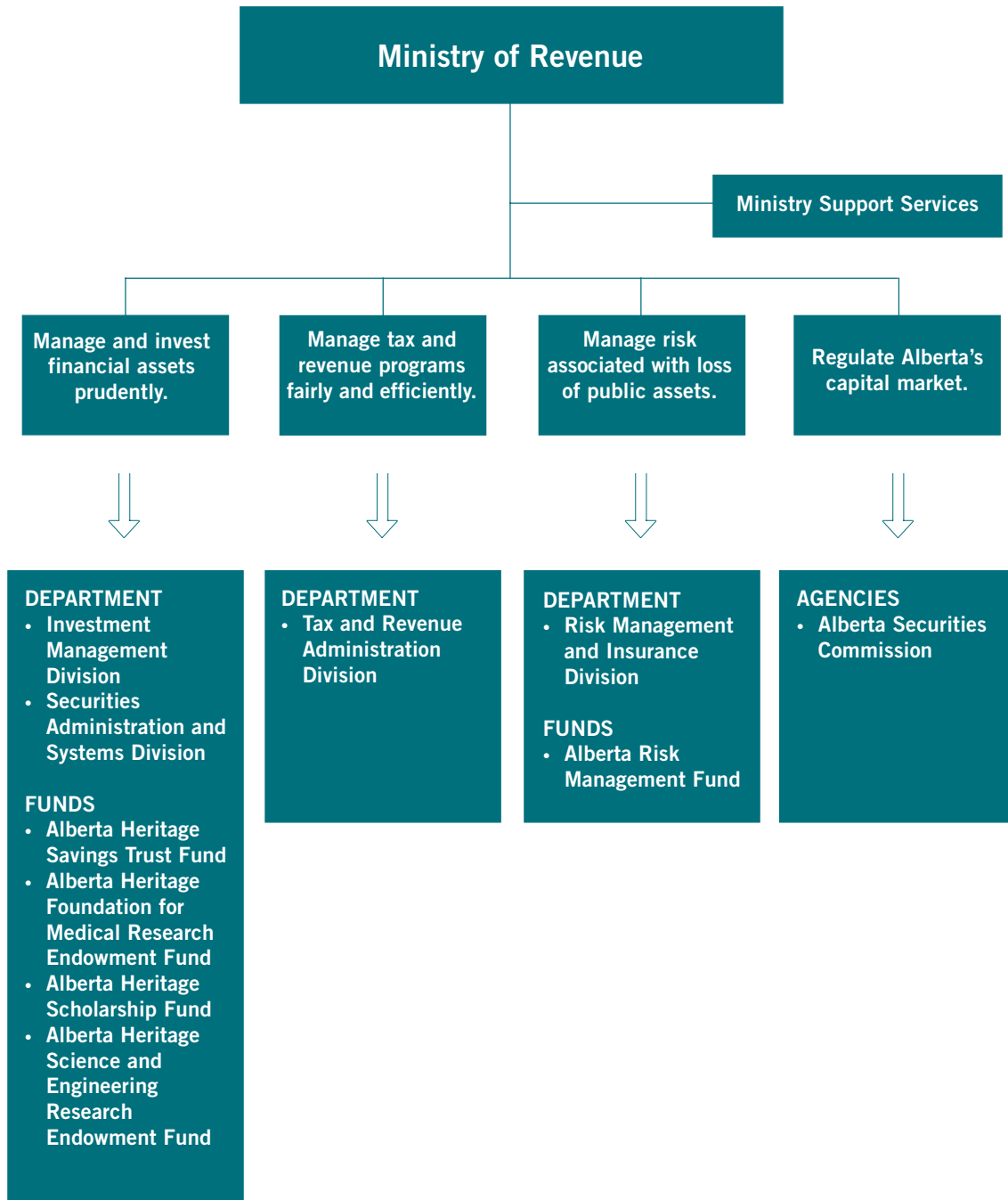
Our mission

“To provide prudent and innovative revenue, investment and risk management and to regulate the capital market in Alberta.”

Revenue’s core businesses

1. Manage tax and revenue programs fairly and efficiently.
2. Manage and invest financial assets prudently.
3. Manage risk associated with the loss of public assets.
4. Regulate Alberta’s capital market.

RELATIONSHIP OF REVENUE DEPARTMENT AND REPORTING ENTITIES TO CORE BUSINESSES



OPERATIONAL OVERVIEW

Department of Revenue www.revenue.gov.ab.ca

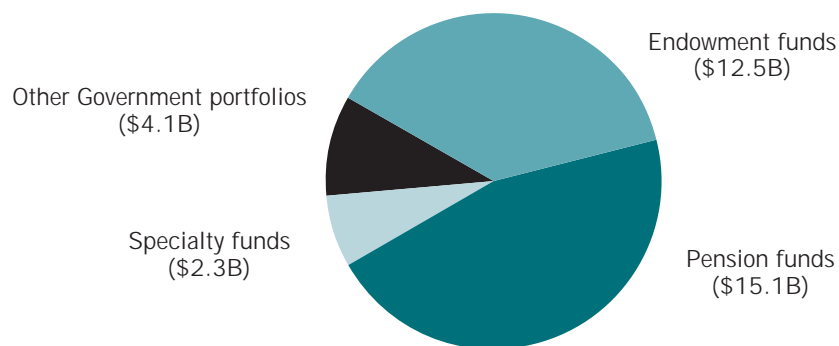
9515 - 107 Street
Edmonton Alberta
T5K 2C3

Investment Management Division

The Investment Management Division (IMD) was established to act as the investment manager for pools of capital assigned by statute to the Minister of Revenue and for investments of other provincial public sector bodies, where specific agreements have been made. With approximately \$34 billion under management, Alberta Revenue is one of the largest fund managers in the country. Assets under management include:

- Endowment funds including the Alberta Heritage Savings Trust Fund (Heritage Fund), the Alberta Heritage Foundation for Medical Research Endowment Fund, the Alberta Heritage Scholarship Fund and the Alberta Heritage Science and Engineering Research Endowment Fund (totalling \$12.5 billion).
- Government sponsored public sector pension plans (\$15.1 billion).
- Other Government portfolios including the Government surplus, the General Revenue Fund and the General Revenue Capital Account (\$4.1 billion).
- Specialty funds including the Power Pool Balancing Fund and funds managed on behalf of the Workers' Compensation Board (\$2.3 billion).

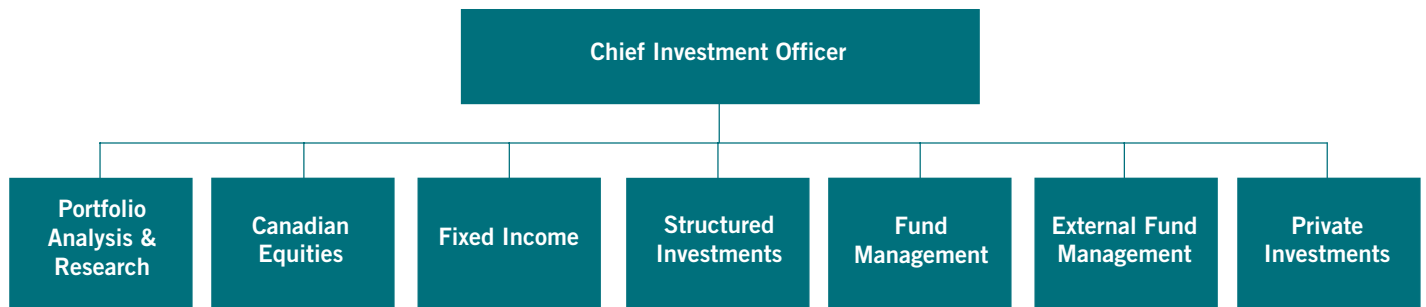
ASSETS UNDER MANAGEMENT BY IMD



Investment objectives vary for the funds, reflecting different financial requirements and risk tolerances for each fund and its respective stakeholders. To meet each fund's investment policies and goals, IMD has developed a wide range of investment products that can be combined to meet specific financial goals and risk tolerances. This multi-product approach is implemented on a pooled basis. Each product is defined by its return objective and risk profile. Clients buy into the pools by purchasing units based on the current market value of the pools' investments. This approach is important to managing the funds efficiently and to ensuring each

client is treated fairly. Both IMD and third party external manager expertise are used, ensuring the necessary specialized investment knowledge and skills are used in the most cost effective manner. External managers are used primarily for investing in foreign equity and certain domestic equity markets.

Results from IMD's annual investment client survey indicate that satisfaction with IMD's service levels decreased to 66 in 2002-03 from 76 in 2001-02 (scale of 100). This performance may have been influenced to some degree by dissatisfaction with the continued poor performance of equity markets.

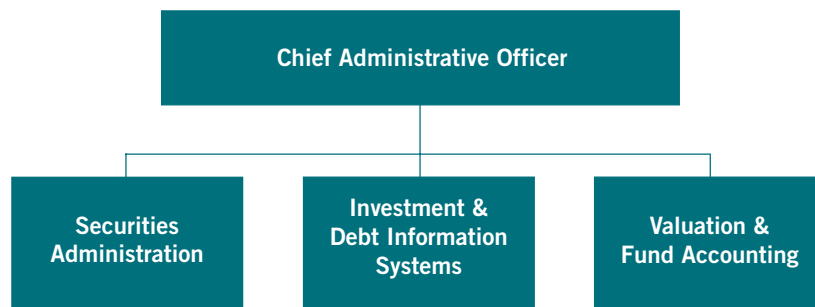


Securities Administration and Systems Division

The Securities Administration and Systems Division (SASD) has three branches - Securities Administration, Investment and Debt Information Systems (IDIS), and Valuation and Fund Accounting. It provides back office support for investment operations including:

- trade transaction monitoring and processing,
- fund and portfolio valuation and performance measurement,
- investment system oversight,
- support systems development and maintenance, and
- custodial interface and oversight.

SASD works with IMD to ensure investment data is captured in the appropriate system and the financial transactions are settled with the corresponding brokers and financial institutions. IDIS is responsible for all of the software and system development required within IMD and SASD. The branch also provides assistance to the Treasury Management Division and the Investment and Debt Accounting Group within Alberta Finance. Valuation and Fund Accounting prepares the weekly valuation of the investment portfolios, measures investment performance and processes pool unit transactions.



Tax and Revenue Administration Division

Tax and Revenue Administration (TRA) is responsible for the collection of revenue, the administration of Alberta Revenue's tax, revenue and related benefit programs and the development of tax policy. The focus is a fair, competitive, simple and efficient provincial tax and revenue system.

The Division has four branches: Revenue Operations, Audit, Tax Services and Business Technology Management. Each branch is responsible for specific business processes. TRA's branches are designed so that business processes that are similar in nature and require similar knowledge and skills are grouped into one area.

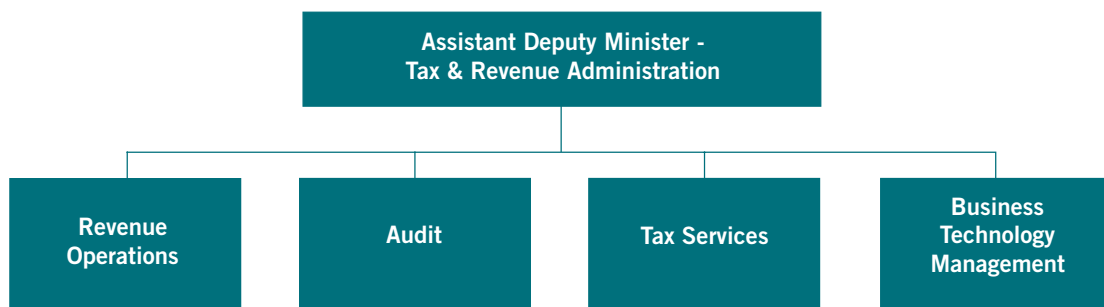
Revenue Operations is responsible for registering corporations, individuals, trusts, fuel tax clients, tobacco tax and other clients under the applicable acts or programs, maintaining client accounts, validating and processing returns and claims and processing remittances and providing refunds to TRA's clients. In 2002, the enforcement of filing requirements and tax debt collection activities were consolidated in Revenue Operations.

Audit is responsible for ensuring the compliance of TRA's clients with the tax acts by auditing the clients'

books and records. Audit also works with other tax administrations and other Government of Alberta ministries on initiatives to develop policies, improve compliance and implement educational strategies required for the proper administration of tax and revenue programs.

Tax Services is responsible for providing information and technical ruling services to TRA's clients and staff and the administration of dispute resolution mechanisms with respect to TRA actions. In 2002, a policy group was incorporated into this branch to develop revenue and tax policy. This group was actively involved in the revenue management framework and tobacco tax amendments initiatives. Tax Services also provides central services to other ministries and their agencies with respect to the federal GST.

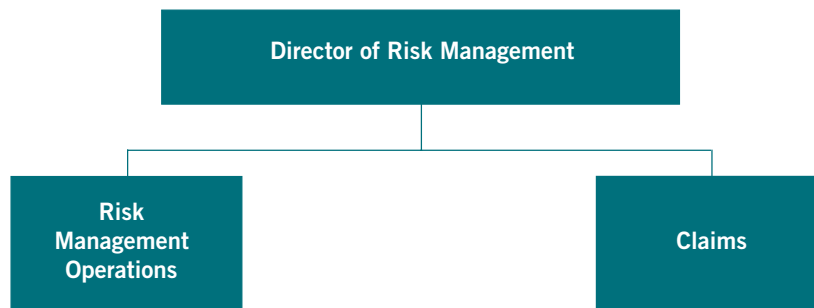
Business Technology Management provides planning, business systems and quality improvement services to TRA. This Branch has the lead responsibility for managing TRA's product development (e.g. electronic commerce, forms, etc.), change management, budgeting/forecasting and management reporting functions.



Risk Management and Insurance Division

The Risk Management and Insurance Division (RMI) administers a program to protect, secure and preserve public assets against risk of accidental loss. RMI provides services to client ministries and agencies throughout government to help identify, measure, control and finance risk. The program is responsible for all entities subject to the *Financial Administration Act*.

There are two branches within this division, Risk Management Operations and Claims. Risk Management Operations assists the Crown to identify, minimize and, where appropriate, finance adverse effects of accidental loss. The Claims Branch administers all claims covered under the province's Risk Management Fund and makes recommendations aimed at reducing risk.



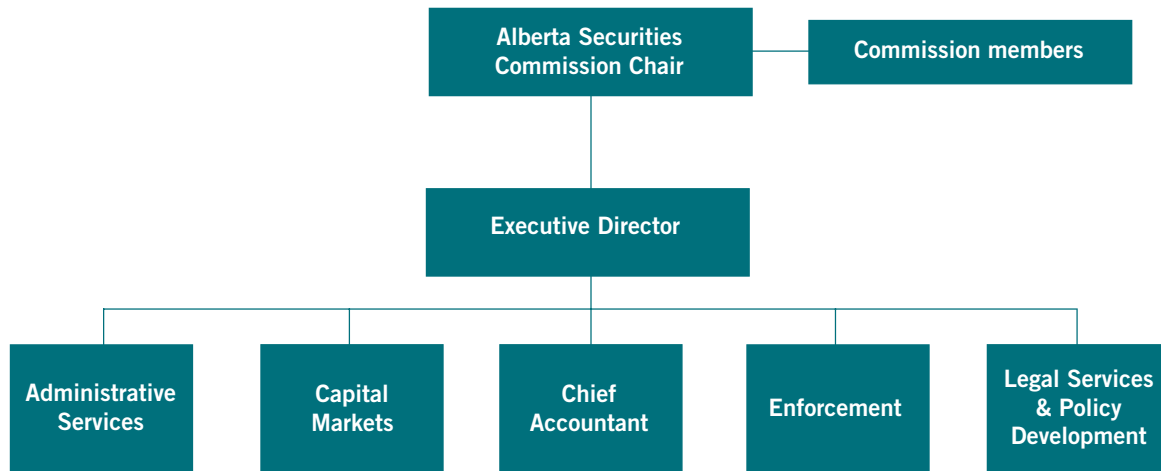
Alberta Securities Commission www.albertasecurities.com

4th Floor, 300 - 5th Avenue SW
Calgary, Alberta
T2P 3C4

The Alberta Securities Commission (ASC) is an industry-funded provincial corporation responsible for maintaining the efficiency and integrity of the capital market in Alberta through the administration of the *Alberta Securities Act*, the Securities Regulation and the Alberta Securities Commission Rules. As a member of the Canadian Securities Administrators (CSA), an organization consisting of the 13 provincial and territorial securities regulators, the ASC plays a vital role in developing and operating a national system of harmonized securities regulation, policy and practice.

The ASC is an administrative tribunal with quasi-judicial powers. Panels of members hear enforcement proceedings and consider applications for discretionary exemptions from the requirements of the securities legislation. The ASC also sits as an appeal body to hear appeals from decisions of the Executive Director, TSX Venture Exchange and the Alberta District Council of the Investment Dealers Association of Canada.

In November 2002, the ASC centralized operations in its Calgary office.



SUMMARY OF KEY ACTIVITIES IN THE PAST YEAR

Looking Forward, the Heritage Fund consultation

More than 77,000 Albertans shared their thoughts on the future of the Alberta Heritage Savings Trust Fund by completing the *Looking Forward: Planning for the Future with the Alberta Heritage Savings Trust Fund* survey. This province-wide survey was one part of an extensive savings review initiative, to ensure policies will help meet the province's needs into the future. Results of the survey can be found at www.revenue.gov.ab.ca.

It is clear Albertans value the Heritage Fund and want to ensure it will be around to benefit future generations. Future changes will focus on strengthening the Fund as an endowment and preserving its value over the long-term.

Developing the Revenue Framework

Alberta Revenue is developing a framework that considers broad characteristics, trends and issues in the province's revenue structure. This framework will ensure decisions can be made to benefit all Albertans over the long-term. Revenue is working with other ministries that are responsible for forecasting and collecting revenues to ensure a cohesive provincial approach to revenue management.

Strengthening Investment Operations

During the year Alberta Revenue took a number of steps to strengthen investment operations. Work commenced on a medium-term strategic plan for the investment operation, which includes four goals:

- Increase value added for clients;
- Strengthen governance and oversight;
- Strengthen client relationships; and
- Be cost effective.

Meanwhile the internally managed Canadian equity portfolio was restructured to improve investment results and a Fund Management Group was established to help pension, endowment and other client funds better achieve their investment objectives.

Alberta Revenue is responsible for the investment management and administration of approximately \$34 billion of assets. These investments include the Alberta Heritage Savings Trust Fund, other provincial endowment funds, public sector pension plans and other investments for government related clients.

As the fifth largest investment organization in the country, the division continues to provide high quality service to government clients at low cost. Clients pay 10 basis points less than they would pay by outsourcing management to the private sector. Ensuring the division provides high quality management cost-efficiently continues to be a key objective.

Straight Through Processing and T+1 Trade Settlement

To meet changing standards in the investment industry, Revenue is acquiring new trading and data integration systems to enhance straight through processing and enable trades to be completed one day after trade date, compared to the current standard of settling three days after the trade date. The project will be completed by 2004-05.

Reviewing and Reforming Securities Regulation

The securities regulatory system promotes confidence in capital markets, enables businesses to access the financing they need to grow, and assures citizens they will be treated fairly when they invest.

In February 2003, provincial and territorial ministers from across the country agreed to study the securities regulatory framework and make improvements that will modernize the system, make it more efficient, and inspire investor confidence. Alberta is leading this initiative. Ministers are studying a passport approach that will allow businesses to operate in all jurisdictions if they are recognized by one. An action plan will be developed by fall 2003.

In addition, securities administrators from across the country have made a strong commitment to eliminating differences in provincial and territorial securities law by participating in the Uniform Securities Legislation (USL) Project. The Alberta Securities Commission is chairing this initiative, and a national framework for securities legislation will be presented to provincial and territorial leaders by the end of the 2003-04 fiscal year.

Corporate Tax Reductions

Competitive tax rates encourage investment, and reductions in Alberta's corporate tax rates continue to make the province globally competitive. This fiscal year, the general rate fell to 13 per cent, the small business rate was reduced to 4.5 per cent, and the small business threshold increased to \$350,000. These reductions saved \$81 million for businesses, in addition to the \$286 million that has been cut from corporate income taxes since 2001. Additional reductions will be made, as affordable, in coming years.

Supporting the Tobacco Reduction Strategy

Ensuring Alberta's health care system continues to provide high quality health care for generations to come is an important government priority. A significant contribution to these efforts is Alberta's tobacco reduction strategy, which is encouraging Albertans, especially young Albertans, to stop smoking, or, better yet, to never take up the habit.

Studies prove that increasing tobacco taxes reduces tobacco use. To support the reduction strategy, tobacco taxes were increased for the first time in 10 years, by 125 per cent. The strategy is working – tax-paid tobacco sales have dropped by nearly 18 per cent. Additional resources were dedicated to enforce legislation and combat smuggling. An information campaign was implemented in stores at border crossings to educate Albertans about tobacco legislation and raise awareness that tobacco can only be purchased for personal use.

Consulting with Stakeholders on Tax Policy

Alberta supports a broad-based, low rate tax system, and will consult with key stakeholders on changes to the tax system. For example, while the Business Tax Review Committee recommended eliminating the rebate portion of the Tax Exempt Fuel Use (TEFU) program, initial consultations found these benefits to be important in some industry segments. Further consultation with key industry associations began in February 2003 and will continue to the next fiscal year, with a view to simplifying the system.

Future Summit

The Future Summit's Report to Government, *Imagine our Tomorrow*, was released in May 2002. Through the Summit, Albertans told government they were committed to a strong fiscal plan that balances fiscal responsibility with sustaining core programs and services - also the goal of Alberta's new fiscal framework. Many of the ideas suggested through the Summit already form part of government business, and government has begun to take action on others. For example, delegates at the Summit supported the creation of a sustainability fund, and Summit findings served as the basis of the recently completed Heritage Fund consultation.

Review of the Risk Management Fund

The Risk Management Fund provides insurance-like coverage to ministries, managing the risk of significant accidental loss to public assets. Following the events of September 11, 2001, insurance premiums have been rising. Over the year, Revenue has reviewed financing strategies for the Fund, including the mix of self-insurance and purchased insurance. Revenue continues to ensure the government's self-financed insurance coverage is cost-effective and efficient.

Implementing the National Hockey League (NHL) Players' Tax

Alberta implemented an NHL Players' Tax that applies to all NHL players for all regular season games played in Alberta. Revenue from this tax will be used to provide a grant to Alberta-based NHL teams that is equal to the revenue raised (minus administrative costs.) This is the first tax designed for electronic, web-based filing and NHL teams have commented on its ease of use.

Payment in Lieu of Tax (PILOT)

As of January 1, 2002, certain municipal-owned electricity companies must make payments equal to what would otherwise be paid in federal and provincial corporate taxes to the Alberta Power Pool. These payments level the playing field with the other companies paying corporate income taxes in the deregulated electricity industry. Alberta Revenue administers this program and has received and assessed its first returns.

LEGISLATION ADMINISTERED BY ALBERTA REVENUE

as at March 31, 2003

The following Acts are the sole responsibility of the Minister of Revenue:

Alberta Heritage Savings Trust Fund Act
Government Fees and Charges Review Act
Financial Administration Act (section 76)

The following Acts are the combined responsibility of the Ministers of Revenue and Finance:

Alberta Corporate Tax Act (except section 26.41)
Alberta Income Tax Act
Alberta Personal Income Tax Act
Financial Administration Act (section 11 and Part 5)
Fuel Tax Act (except sections 12(3), (4), and (5), 34(c), 37(2), 42 and 51(l), (j), and (aa))
Hotel Room Tax Act
Securities Act
Tobacco Tax Act

The following Acts are the combined responsibility of the Ministers of Revenue and Finance and other Ministers:

Alberta Corporate Tax Act (section 26.41 jointly with the Minister of Energy)
Fuel Tax Act (sections 12(3), (4), and (5), 34(c), 37(2), 42 and 51(l), (j), and (aa))
jointly with the Minister of Agriculture, Food and Rural Development)

RESULTS ANALYSIS

2003

- CORE BUSINESSES AND GOALS
- FINANCIAL HIGHLIGHTS
- REPORT OF THE AUDITOR GENERAL ON
THE RESULTS OF APPLYING SPECIFIED AUDITING
PROCEDURES TO KEY PERFORMANCE MEASURES
- PERFORMANCE MEASURES, TARGETS AND RESULTS
- KEY PERFORMANCE MEASURE
METHODOLOGY APPENDIX

CORE BUSINESSES AND GOALS

CORE BUSINESS	GOAL
<p>Manage tax and revenue programs fairly and efficiently.</p>	<ul style="list-style-type: none"> • Maintain and develop a revenue structure that meets Alberta's needs and is consistent with Albertans' values. • Maintain a fair and competitive provincial tax system. • Administer tax and revenue programs fairly, effectively and efficiently.
<p>Manage and invest financial assets prudently.</p>	<ul style="list-style-type: none"> • Develop and implement an investment management framework. • Develop a renewed savings policy for the Province of Alberta. • Maximize investment returns subject to client-defined objectives and policies. • Enhance the efficiency of investment operations.
<p>Manage risk associated with the loss of public assets.</p>	<ul style="list-style-type: none"> • Minimize the cost of loss of public assets and the cost of liability claims. • Identify and prioritize risks and establish contingency plans for Revenue's operations.
<p>Regulate Alberta's capital market.</p>	<ul style="list-style-type: none"> • Improve the regulatory environment and maintain confidence in the Alberta capital market. • Maintain working relationships with industry, other securities regulatory authorities, regulators of financial institutions and government. • Be recognized as a professional organization and be an employer of choice.

FINANCIAL HIGHLIGHTS

Changes from Budget

Revenue
\$1,076 million below
budget (13%)

Expenses
\$22.5 million above
budget (12%)

Change from Previous Fiscal Year

REVENUE

Change from 2001 - 2002

Income Taxes	\$ 441 m
Personal Taxes \$651 m <ul style="list-style-type: none"> · Revenues increased due to continued growth in personal income estimated at 5.8 per cent. · The Energy Tax Refund Program ended in 2001-02. The cost of the program went from \$320 million in 2001-02 to a net receipt of \$4 million in 2002-03. · The increases were partially offset by a \$37 million decline in end of year adjustments. 	
Corporate Taxes (\$210 m) <ul style="list-style-type: none"> · Revenues declined due to the reduction in the corporate tax rates. · Corporate taxable income declined by an estimated 5.4 per cent from 2001-02. 	
Other Taxes	\$ 281 m
<ul style="list-style-type: none"> · Fuel taxes increased as economic and population growth led to increased consumption. \$12 m · Tobacco taxes increased due to increased rates, but were partly offset by lower consumption. \$245 m · Insurance corporation tax revenue increased due to a positive prior year adjustment of \$13 million based on updated historical data. \$26 m · Hotel room tax declined marginally. (\$1 m) · Financial Institution capital tax was eliminated April 1, 2001. The change relates to reassessments of prior year tax. (\$1 m) 	

Change from 2001 - 2002

Investment Income	(\$ 1,217 m)
--------------------------	---------------------

- This was one of the most turbulent and volatile years in the history of financial markets. Tensions in the Middle East, fears of a slowing world economy, unwinding of excess capacity in the technology sector and concerns over corporate governance all contributed to global stock market declines and significant equity losses. (\$1,063 m)
- Interest income declined as the phase-in of the Heritage Fund's endowment portfolio was completed resulting in the shift of investment holdings into equities and real estate consistent with the Fund's long-term investment goals. (\$158 m)
- Real estate investment income was slightly lower. (\$1 m)
- Income was realized from investments in Absolute Return Strategies, a new asset class that uses a wide variety of investments to realize positive investment returns regardless of the overall market direction. \$5 m

Miscellaneous	\$ 2 m
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- Internal Government Transfers related to a contribution to the Alberta Heritage Scholarship Fund from the Ministry of Learning. \$1 m
- Other \$1 m

NET DECREASE IN REVENUE	(\$ 493 m)
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EXPENSES

Change from 2001 - 2002

Corporate tax interest refund	\$ 33 m
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- In 2002-03 Canada Customs and Revenue Agency (CCRA) reached settlements on a number of large objection files. These settlements triggered parallel reassessments for Alberta, resulting in a substantial increase in refund interest being paid out.

Change from 2001 - 2002

Transfers from Endowment Funds	\$ 3 m
---------------------------------------	---------------

- Alberta Heritage Foundation for Medical Research (\$4 m)
- Alberta Heritage Scholarship Fund \$2 m
- Alberta Heritage Foundation for Science and Engineering Research \$5 m

Miscellaneous

\$ 12 m

- Revenue collection and rebates increased primarily due to increased manpower, which was delayed from 2001-02 due to the hiring freeze. This allowed for increased file review. \$2 m
- Regulation of capital markets increased primarily because of the Alberta Securities Commission's one-time cost for closure of its Edmonton office. \$4 m
- Risk Management and Insurance costs increase related to higher third party premium costs and a change in the provision for future claims. \$6 m

NET INCREASE IN EXPENSES**\$ 48 m**

MINISTRY EXPENSE BY CORE BUSINESS

(thousands)

	2002-03 Comparable Budget	2002-03 Actual	2001-02 Comparable Actual
Core Business			
Manage and invest financial assets prudently	116,038	90,364	86,914
Manage tax and revenue programs fairly and efficiently	41,762	84,970	50,312
Manage risk associated with loss of public assets	9,058	12,680	7,147
Regulate Alberta's capital market	17,682	19,013	15,073
Total Expenses	184,540	207,027	159,446



REPORT OF THE AUDITOR GENERAL ON THE RESULTS OF APPLYING SPECIFIED AUDITING PROCEDURES TO PERFORMANCE INFORMATION

To the Members of the Legislative Assembly:

In connection with the Ministry of Revenue's key and supplemental performance measures included in the *2002-2003 Annual Report of the Ministry of Revenue* for the year ended March 31, 2003, I have:

Key Performance Measures

1. Agreed information from an external organization to reports from the organization.
2. Agreed information from reports that originated from organizations included in the consolidated financial statements of the Ministry to source reports. In addition, I tested the procedures used to compile the underlying data into source reports.
3. Checked that the presentation of results is consistent with the stated methodology.
4. Checked that the results presented are comparable to stated targets, and information presented in prior years.
5. Checked that the key performance measures, as well as targets, agree to and include results for all of the measures presented in Budget 2002.

Supplemental Performance Measures

6. Agreed the information to source reports. In addition, I checked that the supporting narrative is consistent with the information.

As a result of applying the above procedures, I found no exceptions. However, these procedures do not constitute an audit, and therefore I express no opinion on the key and supplementary performance measures included in the *2002-2003 Annual Report of the Ministry of Revenue*.

Edmonton, Alberta
August 29, 2003

[original signed]
FCA
Auditor General

PERFORMANCE MEASURES, TARGETS AND RESULTS

Core Business #1 – Manage tax and revenue programs fairly and efficiently.

Consistently low taxes have become one of the defining features of living and doing business in Alberta, and will continue to be a key feature of the new fiscal framework, which will be adopted in 2003-04. Albertans enjoy the advantages of an innovative single-rate personal tax system, continued corporate tax reductions, the lowest fuel tax in Canada, and no general sales tax, payroll tax, or corporate capital tax.

Alberta's low rate, broad based approach to taxes is fairer and simpler for all taxpayers. It is part of the solid foundation for a dynamic and vibrant provincial economy, and means more opportunities, greater rewards for work and investment, and more wealth to support public services and quality of life.

KEY PERFORMANCE MEASURE:

PERFORMANCE MEASURE	TARGET	RESULT
Provincial tax load for a family of four.	• Lowest in Canada	• Lowest in Canada

Alberta continues to have the lowest provincial tax load for a family of four (see chart). Alberta's single-rate personal tax system has two key components that advance fairness and competitiveness. First, the largest personal and spousal exemptions in the country promote fairness by allowing Albertans to earn more tax-free income. Provincial non-refundable credits are indexed to inflation so their value is not eroded over time. Second, the 10 per cent single rate is the lowest top marginal tax rate in Canada. This promotes competitiveness and encourages people to live, work and invest in Alberta.

PROVINCIAL TAX LOAD FOR A FAMILY OF FOUR*

	One-income family with two children earning \$30,000	Two-income family with two children earning \$60,000	Two-income family with two children earning \$100,000
Alberta	\$432	\$4,124	\$7,418
Ontario	\$1,777	\$4,679	\$8,873
Saskatchewan	\$2,352	\$5,204	\$9,527
British Columbia	\$2,836	\$5,338	\$8,593
New Brunswick	\$3,064	\$5,828	\$10,850
Manitoba	\$2,563	\$5,898	\$11,525
Nova Scotia	\$3,209	\$6,200	\$11,457
Prince Edward Island	\$3,269	\$6,230	\$11,291
Quebec	\$1,997	\$6,353	\$14,289
Newfoundland and Labrador	\$4,022	\$7,246	\$13,283

* Includes provincial income, sales, payroll, tobacco and fuel taxes and health care insurance premiums
Source: Alberta Finance (See Key Performance Measure Methodology Appendix at the end of this section.)

The personal tax load on Alberta was the lowest in Canada at 54 per cent of the national average, far ahead of its nearest competitor British Columbia, which is at 90.5 per cent of the national average.

KEY PERFORMANCE MEASURE:

PERFORMANCE MEASURE	TARGET	RESULT
Provincial tax load on business.	• Lowest in Canada	• Third lowest in Canada

In 2002-03, Alberta's provincial tax load on business was the third lowest in Canada, the same ranking as 2001-02 (revised based on latest available information). Alberta did not meet its target of having the lowest business tax load in Canada as it lagged behind Prince Edward Island and British Columbia. British Columbia improved its ranking from ninth overall in 2001-02 to second in 2002-03 because it cut its general corporate income tax rate to 13.5% from 16.5% and eliminated its general capital tax as of September 1, 2002.

Alberta's general corporate tax rate and small business rate, at 13.0% and 4.5% respectively, are the second lowest among all the provinces. Alberta does not have any capital taxes. Low overall taxes in Alberta encourage entrepreneurs to start new businesses in Alberta, or move them here from other provinces.

TAX LOAD ON BUSINESS*

	2002-03	2001-02 (revised)
Prince Edward Island	60.5	72.0
British Columbia	83.6	135.1
Alberta	85.0	76.6
Manitoba	91.6	116.1
Nova Scotia	93.7	72.0
Ontario	96.1	94.9
New Brunswick	96.8	104.8
Quebec	114.8	106.7
Newfoundland and Labrador	120.0	122.2
Saskatchewan	212.4	150.7

* Includes business income taxes, capital taxes, and insurance corporation taxes
Tax load relative to provincial average=100

Source: Federal Department of Finance, July 2003 Interim Estimate for 2002-03;
February 2003 Fifth Estimate for 2001-02; Alberta Finance

Methodology: See Key Performance Measures Methodology Appendix

The government affirmed its commitment to corporate income tax cuts in 2002-03, though the pace of the cuts was slowed in response to a changing fiscal situation. Effective April 1, 2002, the general rate was reduced to 13%, the small business rate was reduced to 4.5%, and the small business threshold was increased to \$350,000. These reductions saved taxpayers \$81 million.

The tax cuts continued in 2003. Effective April 1, 2003, the general rate was reduced to 12.5%, the small business rate was reduced to 4%, and the small business threshold was increased to \$400,000.

REVISED IMPLEMENTATION SCHEDULE FOR THE BUSINESS TAX PLAN

(Effective April 1st each year)

	2002-03	2003-04	2004-05
General rate* (%)	13.0	12.5	11.5
Small business rate (%)	4.5	4.0	3.0
Small business threshold (\$)	350,000	400,000	400,000
Capital gains inclusion rate (%)	50	50	50
Railway fuel tax (¢/litre)	1.5	1.5	1.5
Capital tax	-	-	-

*In 2002, the reduction of the general rate eliminated the need for a separate manufacturing and processing rate.

Supplemental Measures

PERFORMANCE MEASURE: Percentage of tax accounts with no monies owing.

For 2002-03, the target was set at 99 per cent. The actual percentage of accounts with no overdue amounts owing as at March 31, 2003 was 95.62 per cent, up from 95 per cent in 2001-02. This consistently high performance demonstrates Alberta's tax enforcement efforts are successful.

PERFORMANCE MEASURE: Client satisfaction with tax administration.

For the 2002 client survey, Tax and Revenue Administration (TRA) adopted "percentage satisfied" as the new measure of client satisfaction in response to public feedback that the previous measure was difficult to understand. (Note that the comparative 2001-02 results shown below have been restated to the percentage satisfied measure of client satisfaction).

Clients' overall satisfaction with tax administration (88.7 per cent) exceeded the minimum 85 per cent performance target. In comparison to the 2001-02 results, the clients' overall satisfaction with tax administration has decreased slightly by 0.9 per cent from 89.6 per cent in 2001-02, which can be partially attributed to the increased TRA enforcement activities as a result of the tobacco tax rate increases in 2002.

PERFORMANCE MEASURE: Ratio of amounts added to net revenue to costs of administration.

This performance measure is new and replaces the costs per \$100 of tax revenue collected measure reported in 2002. The calculation is based on the total additional revenue obtained through TRA's efforts, shown as a ratio of the total costs of TRA's operating budget.

The total amount added to net revenue for the year was \$229 million, and the associated costs were \$18.7 million, so the value added ratio is 12.3 to 1 – that is, recoveries of \$12.30 for every \$1 spent.

Core Business #2 – Manage and invest financial assets prudently.

The Investment Management Division's primary objective is to maximize long-term financial returns. Meeting this objective means managing the balance between risk and return. The strategies outlined in the Ministry's Business Plan support this objective by using a prudent mix of internal investment resources and external investment management firms, and by developing and implementing new products to meet client needs.

KEY PERFORMANCE MEASURE:

PERFORMANCE MEASURE	TARGET	RESULT	
Annualized market value rates of return (ROR) measured against benchmarks established by clients.	• ROR for the Heritage Endowment Fund exceeds the policy benchmark.	Endowment Fund Return¹ 4 year annualized	Benchmark Return -0.2
		0.4	

¹ Combined Fund (includes Endowment and Transition Portfolios) 4-year annualized return was 0.3%. No combined benchmark exists.

In 1997, the Alberta government adopted a new investment strategy for the Alberta Heritage Savings Trust Fund (Heritage Fund). This new strategy focuses on earning the greatest long-term returns for Albertans, within an acceptable level of risk. To meet this strategy, a plan was put in place to shift the majority of the Fund's assets from exclusively fixed income securities (held in the Transition Portfolio) to a balanced mix of securities (held in the Endowment Portfolio). All assets were shifted to the Endowment Portfolio by July 2002.

As at March 31, 2003, investments in the Heritage Fund policy asset mix was:

Fixed Income Securities	35.0%
Public Equities	50.0%
Real Estate	10.0%
Private Equity	2.0%
Absolute Return Strategies	3.0%

Generally, fixed income securities are less volatile and provide a steady stream of interest income, while equities are more volatile and produce capital gains or losses. Over the long term, equities produce higher rates of return than fixed income securities. The diversification effect of combining fixed income with equities and other asset classes reduces overall risk to the Fund.

The table below shows the actual and benchmark weighting in each asset category as well as the actual and benchmark returns. Returns are calculated on an annual basis with the exception of the four-year calculation, which is the annualized compounded return over four years. The target is to have the Heritage Fund return exceed the policy benchmark return, over a four-year period. The annualized return for the four-year period ended March 31, 2003 is 0.6 per cent greater than the policy benchmark return.

	2003	One Year Return (%)			4 Year
		2002	2001	2000	Compound Annualized (%) Return
Time-weighted rates of return					
Short-term fixed income	3.0	3.8	5.7	5.3	4.5
Scotia Capital 91-day T-Bill Index	2.7	3.7	5.7	4.7	4.2
Long-term fixed income	9.5	5.9	9.5	1.7	6.6
Scotia Capital Bond Universe Index	9.2	5.1	8.7	1.3	6.0
Canadian equities	(16.6)	4.2	(16.0)	37.8	0.1
S&P/TSX Composite Index	(17.6)	4.9	(18.6)	45.5	0.6
United States equities	(30.6)	1.4	(14.4)	13.1	(9.2)
S&P 500 Index	(30.7)	1.6	(15.1)	13.2	(9.3)
Non-North American equities	(29.1)	(5.8)	(22.6)	37.3	(8.2)
MSCI EAFE Index	(29.3)	(7.3)	(19.6)	20.1	(10.8)
Private equities (1)	(3.3)	n/a	n/a	n/a	n/a
Consumer Price Index plus 8%	5.7	n/a	n/a	n/a	n/a
Real estate (2)	9.8	7.3	9.7	5.8	8.1
Consumer Price Index plus 5%	9.6	9.9	11.9	9.9	10.3
Absolute Return Strategies (1)	1.6	n/a	n/a	n/a	n/a
Consumer Price Index plus 6%	4.7	n/a	n/a	n/a	n/a
Endowment portfolio	(11.3)	3.3	(6.1)	18.0	0.4
Policy Benchmark	(11.7)	3.4	(6.2)	15.9	(0.2)
Transition portfolio (3)	0.5	5.3	8.2	3.0	n/a
Overall Return	(11.0)	4.2	(0.1)	9.0	0.3

- 1) Actual and benchmark returns are for six months.
- 2) Effective April 1, 2002, the benchmark changed from the Russell Canadian Property Index (RCPI) to CPI plus 5%. Therefore, the benchmark for four years is a combination of RCPI and CPI plus 5%.
- 3) The Transition Portfolio was wound up in the first half of the year. The actual return of 0.5% is for six months.

An atmosphere of uncertainty prevailed in public equity markets throughout 2002-03. Few investors escaped the effects of significant declines in stock values. Tensions in the Middle East, fears of a slowing world economy, unwinding of excess capacity in the technology sector and concerns over corporate governance all contributed to a general loss of investor confidence in the stock market. Bright spots were fixed income and real estate assets, which outperformed equities consistent to their use as a safe haven during market instability.

- Canadian equity performance as a whole was positive relative to the S&P/TSX Composite Index. A portion of this relative gain was due to small capitalization securities, which significantly outperformed their index.
- Fixed income performance over the year was also positive relative to its benchmarks. The outperformance was primarily due to an overweight in high quality corporate bonds relative to government bonds and the strong performance of private mortgages.
- US equity performance was slightly positive relative to the S&P 500. The outperformance was partly due to an overweight position in small capitalization equities.
- Non-North American equity performance was also positive relative to the MSCI EAFE Index. Value was added through superior security selection and country allocation in the Asia-Pacific region.

Supplemental Measures

PERFORMANCE MEASURES: Straight Through Processing (STP) System fully functional prior to June 2005. Straight Through Processing (STP) of investment transactions.

Alberta Revenue met 2002-03 targets established in its multiyear straight-through processing (STP) plan to establish processes capable of settling trades on a next-day ("T+1") basis before June 2005. A trade order management system, the core of Alberta Revenue's three-year STP initiative, was selected and implementation began during the year. In anticipation of an industry-wide model for STP and T+1 settlement, the investment operation achieved an internal STP rate of 84 per cent by the end of fiscal 2002-03 against its target rate of 75 per cent.

Other key strategies directed at improving efficiency for the year included consolidating investment custody services with a single service provider, and developing a functional disaster recovery location to ensure continuity of investment operations. These initiatives were successfully completed during the year.

Core Business #3 – Manage risk associated with loss of public assets.

The main strategy for the Risk Management Division is to control the cost of risk. Through the Risk Management Fund, coverage is provided to ministries and appropriate insurance services are purchased to protect some of the Fund's financial responsibilities. The events of September 11, 2001 have had a serious impact on the insurance industry, significantly increasing costs and reducing the availability of purchased insurance.

Supplemental Measures

PERFORMANCE MEASURE: Cost of Claims (insurance premiums plus self-insured losses)

Due to the significant reduction of available coverage, even at an increased cost, insurance was purchased with additional exclusions, at a cost of \$1.8 million, \$400,000 more than budgeted. New (in-house) property and liability wordings have been prepared for the term beginning April 1, 2003. Lower fund limits for some in-house (self-insurance) coverage will be introduced allowing better budgeting for unexpected loss. The actual cost of premiums and claims in 2002-03 was \$10.3 million, which exceeded the \$6.6 million target. This resulted from an increased cost of insurance plus higher reserves for new and expected Incurred But Not Reported (IBNR) claims.

An actuarial review of the Risk Management Fund was completed for March 31, 2001. That report confirmed the claims reserving practices of Risk Management Insurance to be appropriate, subject to adjustments of the (IBNR) reserves. Those changes were carried out and the next review is scheduled for summer 2003.

PERFORMANCE MEASURE: Development and implementation of a Business Continuity Plan for critical areas.

After a thorough review of department businesses, a Business Continuity Plan was developed and implemented. Critical operations, systems and employees were identified and plans put in place to ensure that any disruption in normal activity would be minimal.

All critical computer systems for Investment Management have been duplicated and thoroughly tested at an offsite location. The plan will bring investment operations online in a remote location within 24 hours. Key functions of Tax and Revenue Administration and Risk Management will be manually operational within 72 hours.

Core Business #4 – Regulate Alberta’s capital market.

Alberta Revenue places a high priority on ensuring the rules governing capital markets inspire investor confidence and that the province is competitive nationally and internationally. In February 2003, provincial and territorial ministers agreed to study ways to improve the securities regulatory framework and to develop an action plan to implement improvements by September 30, 2003.

The focus of the Alberta Securities Commission (ASC) is the improvement of the regulatory environment, enforcement and working relationships with other regulatory authorities. The Commission included a number of operational strategies in its internal Business Plan that support the Ministry’s goals. The most significant effort is the national initiative to harmonize securities legislation. Increased efforts have also been expended in the enforcement area.

Supplemental Measures

PERFORMANCE MEASURES: Investor education program.

Number of annual examinations.

Legislation for a uniform Securities Act.

Service standards developed and published.

Commission survey on service levels provided to stakeholders.

Educated investors are more likely to make wise investment decisions, which is, in turn, beneficial for Alberta’s capital markets. A comprehensive education program has been developed by the ASC, including two significant research projects to help identify the education needs of Alberta investors. The results of these studies will be used to refine education programs.

Examinations are conducted on selected mutual fund dealers, portfolio managers and scholarship plan dealers each fiscal year. In 2002-03, out of an overall 339 registrants, 154 were subject for review.

Staff from the ASC are significantly involved in projects at a national level through the Canadian Securities Administrators (CSA), which is the organization under which Canada’s 13 securities regulators work towards a harmonized system of securities regulation. Just as the ASC has developed expertise in certain areas as required by the structure of Alberta’s capital markets, so too have its colleagues across Canada. Work at a national level allows securities regulators to leverage those strengths to form a consistent and strong national regulatory presence. A prime example of this collaborative approach is the ASC’s work developing uniform securities legislation, targeted to be enacted by June 30, 2004.

As part of the Canadian Securities Administrators (CSA) the ASC participates in the Mutual Reliance Review System, which sets out standards for the Exemptive Relief Applications and prospectives.

A survey was not sent out in 2002-03 to stakeholders.

KEY PERFORMANCE MEASURE METHODOLOGY APPENDIX

Taxation load for a family of four (shared performance measure with Ministry of Finance)

Calculations are based on the following assumptions:

- Business is assumed to bear between 25 per cent and 60 per cent of the provincial sales tax, depending upon the provincial tax regime.
- In provinces that impose payroll taxes, 75 per cent is assumed to be borne by employees and 25 per cent by employers. The same 75/25 split is assumed for health care insurance premiums.
- Fuel tax is based on estimated consumption of 3,000 litres per year for one income families and 4,500 litres for two income families.
- Tobacco tax is based on estimated consumption of 100 packs per adult per year.
- RRSP/RPP contributions of \$1,000, \$7,800 and \$13,500 are included in the calculation of personal income tax for the \$30,000, \$60,000 and \$100,000 families, respectively.
- For two income families, income and RRSP/RPP contributions are split 60/40 between the two spouses.
- The children in each family are assumed to be 6 and 12 years old.

Tax load on business (shared performance measure with Ministry of Finance)

Provincial tax load, or tax effort, compares actual tax revenues generated within a province to the revenue that the province would generate if it taxed at national-average tax rates. Business taxes examined include business income taxes, capital taxes and insurance corporation taxes.

Each year, the provinces report their tax revenues by these categories to the federal government as part of the reporting requirements for the Equalization Program. The steps to calculate provincial tax loads are:

1. National-average tax rates are calculated by dividing total national tax revenues by the national tax base. The tax base for business income taxes, for example, is corporate profits.
2. The revenue that the province would generate if it taxed at national rates is equal to the national-average tax rate multiplied by the provincial tax base for each of the tax categories.
3. Provincial tax load is equal to the ratio of actual provincial revenues divided by the results of the previous calculation multiplied by 100.

The latest available data are used in these calculations:

- July 2003 Interim Estimates for 2002-03, except for Alberta corporate income tax, which has been adjusted from budget to actual
- February 2003 Fifth Estimate for 2001-02

As a result, the 2001-02 business tax load are restated from what was reported in the Alberta Revenue Annual Report for 2001-02.

Annualized market value rates of return (ROR) measured against benchmarks established by clients

The performance measurement system used by Revenue calculates a total return for each of the investment funds, including both endowment and other client funds.

Investment clients select indices for various asset classes making up their fund policy benchmark composition. Revenue aggregates published returns for these indices into a policy benchmark composite return for each client fund.

A comparison between the Four Year Annualized total rate of return of the fund and its benchmark is made. This comparison is calculated by subtracting the difference of the time-weighted return of the fund versus the time-weighted return of the policy benchmark.

Fund returns are calculated by the Securities Administration and Systems Division.

Benchmark returns are calculated using policy benchmark weights provided by client statements of policy and goals. Return series of indices used to calculate the policy benchmark are sourced from Revenue's custodian and benchmark providers.