

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

Financial Statements

MARCH 31, 2006

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AUDITOR'S REPORT

To the Minister of Finance

I have audited the balance sheet of the Provincial Judges and Masters in Chambers Reserve Fund as at March 31, 2006 and the statement of changes in net assets for the year then ended. These financial statements are the responsibility of the management of the Fund. 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, 2006 and the changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

[Original Signed]

Fred J. Dunn, FCA
Auditor General

Edmonton, Alberta

May 26, 2006

The official version of this Report of the Auditor General, and the information the Report covers, is in printed form.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

BALANCE SHEET

As At March 31, 2006

	2006	2005
	(\$ thousands)	
Assets		
Investments (Note 3)	\$ 86,212	\$ 38,437
Receivable from the Province of Alberta	413	394
	<u>86,625</u>	<u>38,831</u>
Liabilities		
Liability for investment purchases	40,525	-
	<u>46,100</u>	<u>38,831</u>
Amounts owing to the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan (Notes 2(c) and 6)	46,100	38,831
	<u>46,100</u>	<u>38,831</u>
Net Assets	<u>\$ -</u>	<u>\$ -</u>

STATEMENT OF CHANGES IN NET ASSETS

Year Ended March 31, 2006

	2006	2005
	(\$ thousands)	
Increase in assets		
Contributions from the Province of Alberta		
Current service	\$ 5,175	\$ 5,297
Unfunded liabilities	862	862
Investment income	1,232	826
	<u>7,269</u>	<u>6,985</u>
Decrease in assets		
Increase in amounts owing to the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan	7,269	6,985
	<u>-</u>	<u>-</u>
Increase in net assets	-	-
Net assets at beginning of year	-	-
Net assets at end of year	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are part of these financial statements.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

NOTES TO THE FINANCIAL STATEMENTS

March 31, 2006

NOTE 1 AUTHORITY AND PURPOSE

The Provincial Judges and Masters in Chambers Reserve Fund (Reserve Fund) operates under the authority of the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000 and the Provincial Judges and Masters in Chambers Reserve Fund Directive (*Treasury Board Directive 03/01*).

The Reserve Fund is established to collect contributions from the Province of Alberta and to invest the funds which are reserved to meet future benefit payments of the Provincial Judges and Masters in Chambers (Unregistered) Pension Plan (Unregistered Plan). The Unregistered Plan is established to provide additional pension benefits to Provincial Judges and Masters in Chambers whose pensionable earnings are in excess of the *maximum pensionable salary limit* under the federal *Income Tax Act* effective April 1, 1998.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES**(a) Basis of Presentation**

These financial statements are prepared on the going concern basis in accordance with Canadian generally accepted accounting principles. The statements provide information about the net assets available in the Reserve Fund to meet future benefit payments of the Unregistered Plan.

The Reserve Fund's investments are held in pooled investment funds administered by Alberta Finance or external managers appointed by Alberta Finance. Pooled investment funds have a market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units.

(b) Valuation of Assets and Liabilities

Investments are stated at fair value. The methods used to determine the fair value of investments held either by the Reserve Fund or by pooled investment funds are explained in the following paragraphs:

Short-term securities, public fixed income securities and equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

Due to their short term nature, the fair values of deposits, receivables, accrued investment income, payables and accrued liabilities are estimated to approximate their book values.

(c) Income Recognition

Dividends are accrued on the ex-dividend date. Income from other investments is accrued as earned. Gains or losses on investments are recognized concurrently with changes in fair value.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

Note 2 (continued)**(d) Foreign Exchange**

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. At year-end, the fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate. Exchange differences are included in the determination of net investment income.

(e) Valuation of Derivative Contracts

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

Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

Interest rate swaps are valued based on discounted cash flows using current market yields.

Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.

Cross-currency interest rate swaps are valued at quoted prices based on discounted cash flows using current market yields and year-end exchange rates.

Income and expense from derivative contracts are accrued as earned and included in net investment income. Gains and losses on forward foreign exchange contracts are recognized concurrently with changes in fair value.

(f) Liabilities

Accrued liabilities of the Reserve Fund are funded by investment income and contributions from the Province of Alberta.

As at March 31, 2006, current service contributions rates remained unchanged at 36.04% of the pensionable earnings of Provincial Judges and Masters in Chambers that were in excess of the *maximum pensionable salary limit*. The rate was determined by the Unregistered Plan's actuary and approved by the Minister of Finance.

The unfunded liability arising as a result of judicial salary increases recommended by the 2003 Judicial Compensation Commission is financed by additional contributions from the Province of Alberta. The contribution rate is set on the basis that the additional contributions will eliminate the unfunded liability over 15 years.

These amounts represent assets held by the Reserve Fund, which are available to meet future benefit payments of the Unregistered Plan over the long term.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

NOTE 3 INVESTMENTS (SCHEDULES A TO D)

	2006		2005	
	Fair Value		Fair Value	
	(\$ thousands)	%	(\$ thousands)	
Fixed Income Securities (Schedule A)				
Deposit in the Consolidated Cash				
Investment Trust Fund (a)	\$ 45,683	53.0	\$ 38,437	100.0
Canadian Dollar Public Bond Pool (b)	16,525	19.2	-	-
Total fixed income securities	62,208	72.2	38,437	100.0
Canadian Equities (Schedule B)				
Domestic Passive Equity Pooled Fund (c)	3,325	3.9	-	-
Canadian Pooled Equities Fund (d)	2,025	2.3	-	-
External Managers				
Canadian Equity Enhanced Index Pool (e)	1,000	1.1	-	-
Canadian Large Cap Equity Pool (f)	700	0.8	-	-
Growing Equity Income Pool (g)	420	0.5	-	-
Canadian Multi-Cap Pool (h)	400	0.5	-	-
	7,870	9.1	-	-
United States Equities (Schedule C)				
S&P 500 Pooled Index Fund (i)	7,000	8.1	-	-
External Managers				
US Mid/Small Cap Equity Pool (j)	1,000	1.2	-	-
Growing Equity Income Pool	130	0.1	-	-
	8,130	9.4	-	-
Non-North American Equities (Schedule D)				
External Managers				
EAFE Active Equity Pool (k)	6,000	7.0	-	-
Emerging Markets Equity Pool (l)	500	0.6	-	-
EAFE Structured Equity Pooled Fund (m)	1,500	1.7	-	-
	8,000	9.3	-	-
Alternative Investment- Equities				
Private Income Pool	4	-	-	-
Total equities	24,004	27.8	-	-
Total investments	\$ 86,212	100.0	\$ 38,437	100.0

- (a) The Consolidated Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining maximum 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.
- (b) The Canadian Dollar Public Bond Pool is managed with the objective of providing competitive returns comparable 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 portfolio is comprised of high quality Canadian fixed income instruments and debt related derivatives. Competitive returns are achieved through management of the portfolio duration and sector rotation.
- (c) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the total return of the Toronto Stock Exchange S&P/TSX Composite Index. The portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX Composite Index.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

Note 3 (continued)

- (d) The Canadian Pooled Equities Fund is managed with the objective of providing returns higher than the total return of the S&P/TSX Composite Index while maintaining preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations and is designed to reduce risk by prudent security selection while remaining sector neutral.
- (e) The External Managers Canadian Equity Enhanced Index Pool consists of a single portfolio of publicly traded Canadian equities in the large cap market and is designed to generate a consistent level of investment return above the total return of the S&P/TSX Composite Index over a four-year period with relatively low risk.
- (f) The External Managers 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 markets. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period while reducing return volatility through multiple managers each of whom has a different investment style and market capitalization focus.
- (g) The Growing Equity Income Pool is managed with the objective of providing returns higher than the total return of the S&P/TSX Custom Dividend Index over a four-year period. The pool is intended to provide a steady stream of dividend income with potential for capital appreciation by investing in dividend-paying Canadian and US companies that exhibit attractive valuation, growth and quality financial characteristics.
- (h) The Canadian Multi-Cap Pool consists of a single portfolio with multiple components. The large cap component is internally managed and provides exposure to the Canadian equity market through structured investments replicating the S&P/TSX 60 Index. The small/mid cap component is managed by an external manager with expertise in the Canadian small/mid cap markets. The performance objective is to provide investment returns higher than the total return of the S&P/TSX Composite Index over a four-year period.
- (i) The S&P 500 Pooled Index Fund is passively managed. The portfolio is comprised of publicly traded United States equities similar in weights to the Standard & Poor's S&P 500 Index. The performance objective is to provide investment returns comparable to the total return of the S&P 500 Index. The pool utilizes a combination of pure security replication and synthetic replication strategies to obtain exposure to the benchmark. To enhance investment returns with no substantial increase in risks, the pools also invests in futures, swaps and other structured investments.
- (j) The External Managers US Mid/Small Cap Equity Pool consists of multiple portfolios of publicly traded United States equities. The portfolios are actively managed by an external managers with expertise in the US mid/small cap equity markets. The performance objective is to provide returns higher than the total return of the Russell 2500 Index and/or the S&P 500 Total Return Index over a four-year period while reducing return volatility through multiple investment styles and unique market capitalization focus.
- (k) The External Managers EAFE (Europe, Australasia and Far East) Active Equity Pool consists of multiple portfolios of publicly traded Non-North American equities. Each portfolio is actively managed by an external manager and has constraints on foreign currency management, country allocation, stock selection and investments in emerging markets. The performance objective is to provide investment returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE Index over a four-year period while reducing return volatility through multiple manager investment styles and market diversification.
- (l) The External Managers Emerging Markets Equity Pool consists of publicly traded equities in emerging markets around the world. The portfolios are 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 International Emerging Markets Free (MSCI EMF) Index over a four-year period.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

Note 3 (continued)

- (m) The EAFE Structured Equity Pooled Fund's performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period. The pooled fund provides exposure to foreign markets in Europe, Australasia and the Far East through the use of structured investments such as foreign equity index swaps. The pooled fund also invests in the Floating Rate Note Pool to generate the floating rate cash flows needed for its equity swap obligations.

NOTE 4 INVESTMENT RISK MANAGEMENT

Fair values of investments 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 the best possible return at an acceptable level of risk, the Minister has established a long-term policy asset mix of 44% fixed income instruments and 56% equities to the combined investments held by the Reserve Fund and the Unregistered Plan (see Note 6). Investment 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 a 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 Reserve Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to credit, interest and foreign currency risks, 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.

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. For credit default swaps, parties buy and sell insurance against credit risks inherent in bonds. Periodic payments, based on a notional amount, are exchanged for a contingent payment following a defined credit event of a reference entity.

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. There are underlying securities supporting all swaps. Leveraging is not allowed.

Forward foreign exchange contracts are agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

Note 5 (continued)

Equity index futures contracts are agreements to receive or pay cash on an agreed settlement date based on changes in the level of a specified stock index in the future.

The following is a summary of the Reserve Fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2006:

	Maturity			2006		2005	
				Notional	Net	Notional	Net
	Under	1 to 3	Over	Amount	Value	Amount	Fair
1 Year	Years	3 Years	(\$ thousands)				
%	1 Year	Years	3 Years	Amount	Value	Amount	Value
Equity index swap contracts	67	33	-	\$ 7,873	\$ 165	\$ -	\$ -
Credit default swap contracts	1	4	95	5,449	13	-	-
Interest rate swap contracts	44	42	14	4,148	(8)	-	-
Cross-currency interest rate swap contracts	12	31	57	2,835	206	-	-
Bond index swap contracts	100	-	-	989	98	-	-
Equity index futures contracts	100	-	-	751	24	-	-
Forward foreign exchange contracts	100	-	-	447	3	-	-
				\$ 22,492	\$ 501	\$ -	\$ -

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

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 Reserve Fund attempts to limit its credit exposure by dealing with counter-parties believed to have good credit standing.

NOTE 6 PROVINCIAL JUDGES AND MASTERS IN CHAMBERS (UNREGISTERED) PENSION PLAN (UNREGISTERED PLAN)

An actuarial valuation of the Unregistered Plan was carried out as at December 31, 2005 by Johnson Incorporated and was then extrapolated to March 31, 2006.

As at March 31, 2006, the Unregistered Plan reported an actuarial deficiency of \$4.4 million (2005 \$0.5 million), taking into account the amounts owing from the Reserve Fund.

NOTE 7 COMPARATIVE FIGURES

Comparative figures have been restated to be consistent with 2006 presentation.

NOTE 8 APPROVAL OF FINANCIAL STATEMENTS

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

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

SCHEDULES TO THE FINANCIAL STATEMENTS

SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES

Schedule A

March 31, 2006

	Reserve Fund's Share	
	2006	2005
	(\$ thousands)	
Deposits and short-term securities	\$ 45,785	\$ 38,437
Fixed income securities (a)		
Government of Canada, direct and guaranteed	4,480	-
Provincial, direct and guaranteed		
Alberta	98	-
Other	2,932	-
Municipal	84	-
Corporate, public and private	8,606	-
	16,200	-
Receivable from sale of investments and accrued investment income	354	-
Liabilities for investment purchases	(131)	-
	223	-
	\$ 62,208	\$ 38,437

(a) Fixed income securities held as at March 31, 2006 had an average effective market yield of 4.70% per annum. The following term structure of these securities as at March 31, 2006 was based on principal amount:

	2006	2005
	%	
under 1 year	2	100
1 to 5 years	34	-
6 to 10 years	33	-
11 to 20 years	12	-
over 20 years	19	-
	100	100

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES**Schedule B**

March 31, 2006

	Reserve Fund's Share	
	2006	2005
	(\$ thousands)	
Deposits and short-term securities	\$ 37	\$ -
Public equities (a) (b)		
Consumer discretionary	403	-
Consumer staples	229	-
Energy	2,192	-
Financials	2,360	-
Health care	83	-
Industrials	467	-
Information technology	322	-
Materials	1,159	-
Telecommunication services	371	-
Utilities	77	-
	7,663	-
Small Cap pooled fund	120	-
Receivable from sale of investments and accrued investment income	171	-
Liabilities for investment purchases	(121)	-
	50	-
	\$ 7,870	\$ -

- (a) The Reserve Fund's net investment in Canadian public equities includes the notional amount of Canadian equity index swap contracts and equity index futures contracts totalling \$2,510,000 (2005 \$nil).
- (b) The sector classification conforms to the Global Industry Classification Standard followed by the Toronto Stock Exchange S&P/TSX Composite Index.

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SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES

Schedule C

March 31, 2006

	Reserve Fund's Share	
	2006	2005
	(\$ thousands)	
Deposits and short-term securities	\$ 29	\$ -
Public equities (a) (b)		
Consumer discretionary	853	-
Consumer staples	681	-
Energy	758	-
Financials	1,706	-
Health care	1,033	-
Industrials	1,003	-
Information technology	1,245	-
Materials	284	-
Telecommunication services	234	-
Utilities	254	-
	8,051	-
Receivable from sale of investments and accrued investment income	318	-
Liabilities for investment purchases	(268)	-
	50	-
	\$ 8,130	\$ -

(a) The Reserve Fund's net investment in United States public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totalling \$3,451,000 (2005 \$Nil).

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

PROVINCIAL JUDGES AND MASTERS IN CHAMBERS RESERVE FUND

SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES

Schedule D

March 31, 2006

	Reserve Fund's Share	
	2006	2005
	(\$ thousands)	
Deposits and short-term securities	\$ 182	\$ -
Public equities (a)		
Consumer discretionary	899	-
Consumer staples	459	-
Energy	568	-
Financials	2,213	-
Health care	526	-
Industrials	1,012	-
Information technology	515	-
Materials	624	-
Telecommunications services	417	-
Utilities	333	-
	7,566	-
Emerging market pooled funds	194	-
Receivable from sale of investments and accrued investment income	232	-
Liabilities for investment purchases	(174)	-
	58	-
	\$ 8,000	\$ -

- (a) The Reserve Fund's effective net investment in non-North American public equities includes the notional amount of US equity index swap contracts and equity index futures contracts totaling \$1,433,000.
- (b) The sector classification conforms to the Global Industry Classification Standard followed by Standard & Poor's. The following is a summary of the Reserve Fund's investment in Non-North American public equities by country based on geographic location of stock exchange on which stocks were purchased.

	Reserve Fund's Share	
	2006	2005
	(\$ thousands)	
Japan	\$ 1,761	\$ -
United Kingdom	1,489	-
France	770	-
Germany	514	-
Switzerland	510	-
Netherlands	391	-
Australia	280	-
Italy	241	-
Spain	208	-
Sweden	156	-
Other	1,246	-
	\$ 7,566	\$ -

