



Canada Pension Plan

ANNUAL REPORT OF THE
Canada Pension Plan
2002-2003

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Fiscal Year 2002-2003

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(CCRA), Public Works and Government
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Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2002-2003.

Respectfully,

Ralph Goodale
Minister of Finance

Liza Frulla
Minister of
Social Development

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During the period covered by this report, the Canada Pension Plan was administered by Human Resources Development Canada (HRDC). In December 2003, HRDC was divided into Social Development Canada (SDC) and Human Resources and Skills Development Canada. Responsibility for administration of the Plan now rests with SDC. At the same time, the Canada Customs and Revenue Agency became the Canada Revenue Agency.

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This report on the Canada Pension Plan (CPP) consolidates input from all departments providing services on behalf of the Plan: Human Resources Development Canada (HRDC), the Department of Finance, the Canada Customs and Revenue Agency (CCRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).



2002-2003 The Year at a Glance

IN FISCAL 2002-2003:

- Federal and provincial finance ministers, as joint stewards of the Canada Pension Plan, completed their triennial financial review of the Plan in January 2003. The review, based on the findings of the *Eighteenth Actuarial Report*, confirmed that the combined 9.9 percent employer-employee contribution rate is sufficient to sustain the Plan for the next 75 years.
- 3.7 million Canadians received benefits from the Canada Pension Plan, with a total value of approximately \$21.6 billion.
- 11.1 million people contributed to the CPP.
- 4.3 million people received Statements of Contributions.
- Administrative costs amounted to approximately \$422 million, or 1.95 percent of the \$21.6 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- 2.9 million people received \$15.1 billion in CPP retirement pensions.
- About 909,000 surviving spouses or common-law partners and 86,000 children of deceased contributors received over \$3.3 billion in CPP benefits.
- About 283,000 persons with disabilities and 90,000 of their children received almost \$3 billion in CPP disability benefits.
- On March 31, 2003, total CPP assets were valued at approximately \$53.8 billion and equalled 2.5 years of benefits. The assets were held in provincial, territorial and federal government bonds, short-term investments, and domestic and foreign equities. Bonds are valued at cost and equities are valued at market valuation.
- Bill C-3 was introduced in Parliament in September 2002. It proposes to transfer all CPP assets to the CPP Investment Board. The Bill is the final step in implementing the investment changes agreed to by federal and provincial governments in the 1997 CPP reforms. (The Bill received Royal Assent on April 3, 2003.)
- The *Nineteenth Actuarial Report* was prepared by the Chief Actuary in response to Bill C-3. The Report concludes that transferring all Plan assets to the CPP Investment Board could increase CPP assets by about \$85 billion over 50 years.
- Changes to the *Canada Pension Plan Regulations* were implemented on January 1, 2003, to reflect both the scheduled increase in the annual contribution rate to 9.9 percent and the statutory increase in maximum pensionable earnings (\$39,900 for 2003). The contribution rate increase fully implements the 1997 reforms agreed to by the federal and provincial governments.

The Canada Pension Plan in Brief

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own plan, the QPP, and participates in the decision making of the CPP. Benefits from either plan are based on pension credits accumulated under both. The plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (Information on the QPP is available from the Régie des rentes du Québec at www.rrq.gouv.qc.ca.)

While it is perhaps best known for its retirement pensions, the CPP also provides children's, survivor, disability and death benefits. The CPP administers the largest long-term disability plan in Canada. Vocational rehabilitation services offered under the Plan help some disability beneficiaries regain their independence by making it possible for them to return to the paid labour force, following a customized return-to-work plan.

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for CPP and for other countries' public pensions.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP. Benefits are not paid automatically – everyone must apply and provide proof of eligibility. However, once eligibility is determined, CPP benefits are paid even if the beneficiary also receives income from other sources. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index.





Financing the CPP

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This is to ensure that the long-term financial implications of proposed Plan changes are given due consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless all the provinces waive this requirement, and after Provincial Orders in Council confirming the changes have been passed. Quebec participates in decision making regarding changes to the CPP legislation, even though it has opted out of the CPP and administers its own plan. The Quebec Pension Plan must be involved in changes to the CPP if the two plans are to remain parallel.

In the fall of 2002, Bill C-3, *An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*, was introduced in Parliament. The Bill is the final step in the investment changes agreed to by the federal and provincial ministers in 1997. The goal is to have CPP assets prudently invested in a diversified portfolio of securities at arm's length from government to better manage risk and return. The Bill enables the transfer of the bond portfolio and the operating balance (which are currently managed by the federal government) to the CPP Investment Board. Consolidating all assets in one professionally managed organization will allow the CPP Investment Board to determine the best asset mix and investment strategy. The intent is to enhance rates of return and improve risk management for plan members. The Bill received Royal Assent in April 2003.

The finance ministers announced the completion of their most recent triennial financial review of the CPP in January 2003. As part of the review, they agreed to leave the schedule of contribution rates unchanged. The *Eighteenth Actuarial Report*, which was prepared for the review, confirmed the financial sustainability of the Plan (taking into account the projected aging of Canada's population). Further information on the most recent report as well as previous reviews of the Plan can be found at www.cpp-rpc.gc.ca.

The most recent federal-provincial review confirms the success of the 1997 Canada Pension Plan reforms in putting Plan finances on a sustainable track.

It also recognizes the ongoing success of federal-provincial co-operation in this area. This should strengthen the confidence of Canadians in the future health of Canada's retirement income system, of which the Canada Pension Plan is an important part. The federal and provincial ministers must complete the next financial review of the Canada Pension Plan by the end of 2005.

ACTUARIAL REPORTING

The *Nineteenth Actuarial Report*, tabled in Parliament by the Minister of Finance in 2002, projects the effect of Bill C-3 on the long-term financial status of the CPP. As required by the legislation, the Chief Actuary used the same assumptions and methods as in the *Eighteenth Actuarial Report* (prepared for the most recent triennial financial review of the plan). These were modified to take into account the proposed legislative change.

In the *Nineteenth Actuarial Report*, the Chief Actuary concludes that the legislated contribution rate (9.9 percent in 2003 and thereafter) should be sufficient to pay for future expenditures. The rate is also expected to accumulate assets of \$1,578 billion by 2050, or 5.9 times annual Plan expenditures. The transfer of the bond portfolio and operating balance to the CPP Investment Board is expected to contribute a projected \$85 billion over 50 years to asset accumulation. According to the Chief Actuary, the anticipated pool of assets should make it possible to absorb any unforeseen economic or demographic fluctuations without an increase in the contribution rate. Such fluctuations would otherwise have required an increase in the contribution rate above 9.9 percent. The *Nineteenth Actuarial Report* can be found at www.osfi-bsif.gc.ca/eng/office/actuarial-reports/index.asp, as can previous actuarial reports.

The *Eighteenth Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2001. It provides an actuarial examination of the Plan as at December 31, 2000. The Report was reviewed by a panel of independent actuaries, and their conclusions should give Canadians confidence in the actuarial projections on the CPP. The panel concluded that the Report is based on economic and demographic assumptions that are reasonable in the aggregate (though somewhat on the conservative side). It also stated that the Report meets current professional standards of actuarial practice and uses data and methodologies that are appropriate and reasonable. In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. The panel's report and recommendations can be found at www.osfi-bsif.gc.ca/eng/office/actuarial-reports/index.asp.





A FAIR APPROACH TO FUNDING

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

The federal and provincial governments decided to keep contributions at a reasonable level while beginning to pay full retirement benefits as early as the mid-1970s. This was important – many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings.

However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again – to 14.2 percent by 2030 – to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state financing

To reduce the burden on future generations, the federal and provincial governments introduced “steady-state” financing in 1998. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

Steady-state financing will generate a level of contributions between 2001 and 2020 that exceeds the benefits paid out every year during this period. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment. As a result, Plan assets will cover an increasing number of years of expenditures over this period. Over time, this will create a large enough reserve to help pay the growing costs that are expected as more and more “baby boomers” begin to collect their retirement pension.

After 2020, as the last of the baby boomers retire, and benefits paid begin to exceed contributions, investment revenues from the CPP’s accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach adopted in 1998 is a cross between full funding and pay-as-you-go. Moving to a full-funding approach would have created unfairness across the generations. During the transition, contributors of some generations would have paid higher contributions than others –

they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. A pure pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.





Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2003, total CPP assets were valued at approximately \$53.8 billion (equal to 2.5 years' worth of benefits). Net plan assets are contributions and investment income that have accumulated since the Plan's inception in 1966 – less benefit and administrative expenditures over the same period. Plan assets are expected to increase appreciably over the next 20 years.

CPP ACCOUNT

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP Account is not part of the federal government's revenues and expenditures.

For the year ending March 31, 2003, the CPP Account's operating balance was maintained at a level designed to cover three months' worth of forecast benefit payments and administrative charges. The CPP legislation currently requires the operating balance to be maintained at this level at all times. When Bill C-3 (*An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*) comes into force, the CPPIB will assume responsibility for CPP cash management and will determine the

appropriate level of short-term Plan assets to meet the liquidity needs for investment and benefit payments.

During 2002-03, the cash operating balance earned a weighted average interest rate of 2.64 percent, or \$169 million.

CPP INVESTMENT FUND

Before the 1998 changes to the CPP's investment policy, funds not immediately needed to pay benefits and maintain liquidity in the CPP Account were invested only in long-term bonds of the provincial and territorial governments, provincial Crown agencies, and the Government of Canada. All securities held were invested for 20-year terms. The balance in the Investment Fund on March 31, 2003, was \$26.6 billion, down from \$28.3 billion in March 2002 because of non-renewal of maturing bonds.

Since 1998, funds coming into the Plan that are not immediately needed to pay benefits and Investment Fund securities that are redeemed have been transferred to the CPP Investment Board to be invested in capital markets. As a transitional measure, all provinces and territories can roll over their CPP borrowings at maturity for one additional 20-year term if they wish, at the same rate of interest as they would pay on their other market borrowings at the same time.

During the 1999 federal-provincial triennial review, a decision was made to amend the CPP legislation. The amendment gives the provinces and territories the option of prepaying some or all of their CPP borrowings at market rates of interest, at no cost to the Plan. This option, which was implemented in January 2001, can assist provinces that wish to accelerate the repayment of their debt.



Interest

In 2002-03, the Investment Fund earned about \$2.7 billion in interest, which was deposited in the CPP Account. This compares with \$3 billion earned in the previous 12 months. The Canada Pension Plan Financial Statements summarize the status of the Investment Fund as at March 31, 2003 (see page 23).

Maturing securities are redeemed by the federal government, provinces and territories as they come due. In 2002-03, \$2.4 billion worth of bonds matured; of those, the provinces and territories renewed \$680 million for an additional 20-year term.

Rates of return

The Investment Fund continues to benefit from the high rates of return for securities that were bought in the early 1980s when interest rates were relatively high. These securities are 20-year government bonds bearing a weighted average annual nominal return of 9.93 percent. The Fund's average nominal rate of return can be expected to remain above 8 percent for the next several years. For this reason, the short-term rate of return, based on these investments, will exceed the Fund's expected long-term rate of return of 6.5 percent, or 3.5 percent after inflation.

CPP INVESTMENT BOARD

The CPP Investment Board (CPPIB) was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

On March 31, 2003, the market value of assets invested by the CPPIB in Canadian and foreign equities and real estate totalled \$17.5 billion, which represented about 32 percent of the Plan's assets. The CPPIB's annual report and its quarterly financial statements can be found at www.cppib.ca.

The Board operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP "in the best interests of the contributors and beneficiaries of the Plan." The Board is to "invest its assets with a view to achieving a maximum rate of return, without undue risk of loss." The CPPIB must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

In developing its asset mix policy, the CPPIB considers the Plan's fixed income assets (the bond portfolio and operating balance), which are currently administered by the Department of Finance. As a result, the Board is building a diversified portfolio to balance the existing government bonds and is investing in public and private equities and real estate. It will also consider infrastructure investments in the future.

The CPPIB has a long-term investment horizon. The Chief Actuary estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from the Board for 18 years.

Further information on the CPPIB's mandate, structure and investment policy can be found on its Web site.

Current investments

As at March 31, 2003, the CPPIB's \$17.5 billion in assets were invested as follows: 63 percent in Canadian public equity markets, 24 percent in public equity markets in the United States, Europe and Asia, 9 percent in Canadian and non-Canadian private equities, 2 percent in real estate, and 2 percent in short-term liquid assets.

The CPPIB has full discretion within the framework provided by the legislation over its investment policy. It is subject to the foreign property rule under the *Income Tax Act* and may invest up to 30 percent of the book value of its assets outside Canada. Its equity portfolios are now managed in-house to reduce costs and to help with the management of its passively invested portfolios.

As of March 31, 2003, the CPPIB had committed \$5.1 billion to private equity investments and actually invested \$1.5 billion, or approximately 9 percent of the CPPIB's total assets, in private equities.

The CPPIB initiated its exposure to real estate with investments in publicly traded real estate companies and privately-held real estate totalling \$313 million.

During the 2002-03 fiscal year, the CPPIB's equity and real estate portfolio lost \$4.1 billion, representing a rate of return of negative 21.1 percent.

The CPPIB has stated that this type of short-term volatility is expected, is within risk parameters, and has no impact on current CPP benefits. It sees a more relevant perspective as the long-term goal of building a diversified portfolio to enhance long-term returns and mitigate risk to help sustain the CPP over the next 20 to 50 years.

Investing for our future

The CPPIB has expanded into private equities through externally managed funds that provide venture capital and expansion financing to private companies. It expects to commit as much as 10 percent of total equities to private equities and 5 percent to other private market investments such as real estate and infrastructure. These investments will be made through limited partnerships or pooled funds managed by investment firms in Canada and around the world.

In compliance with its statutory requirement to hold a public meeting in each participating province at least once every two years, the Board held public meetings in the provincial capitals in January 2001 and June 2002.



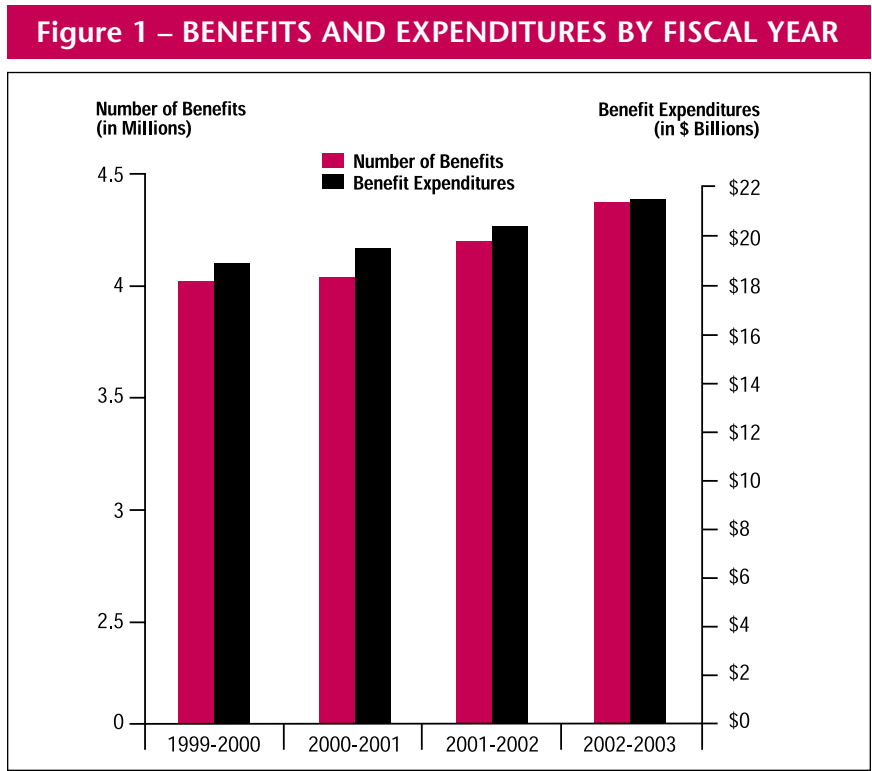
Benefits and Expenditures

The number of people receiving CPP benefits has increased steadily over the past decade. To pay for these benefits, expenditures have also increased. Figure 1 shows the yearly increases since 1999-2000. Figure 2 shows the percentage of CPP expenditures by type of benefit.

RETIREMENT PENSIONS

Retirement pensions represent 66 percent of the total number of CPP benefits paid and 70 percent of the total benefit dollars paid out by the CPP in 2002-03. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2003, the monthly maximum retirement pension was \$801.25; the average payment was \$447.18.

The CPP offers flexibility with respect to the age of retirement. Seniors can take their pension as early as the age of 60 or as late as 70. The CPP permanently reduces the pension by 0.5 percent per month for those who take their benefit before their 65th birthday, reflecting the fact that these seniors will, on average, receive their benefit longer than someone who retires at the age of 65. For those who take their benefit after their 65th birthday, the CPP permanently increases the pension by 0.5 percent per month, reflecting the fact that these seniors will receive their benefit for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003.



The study is available at www.osfi-bsif.gc.ca/eng/office/actuarialinstructions/index.asp.

DISABILITY BENEFITS

Disability benefits, paid to eligible contributors and their children, represent 9 percent of the total number of CPP benefits paid and 14 percent of the total benefit dollars paid out by the CPP in 2002-03. In March 2003, the maximum monthly disability benefit was \$971.26; the average payment was \$729.61. The children's monthly benefit was a flat rate of \$186.71.

SURVIVOR BENEFITS

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 23 percent of the total number of CPP benefits paid and 15 percent of the total benefit dollars paid out by the CPP in 2002-03. The amount of the monthly survivor benefit varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits.

DEATH BENEFITS

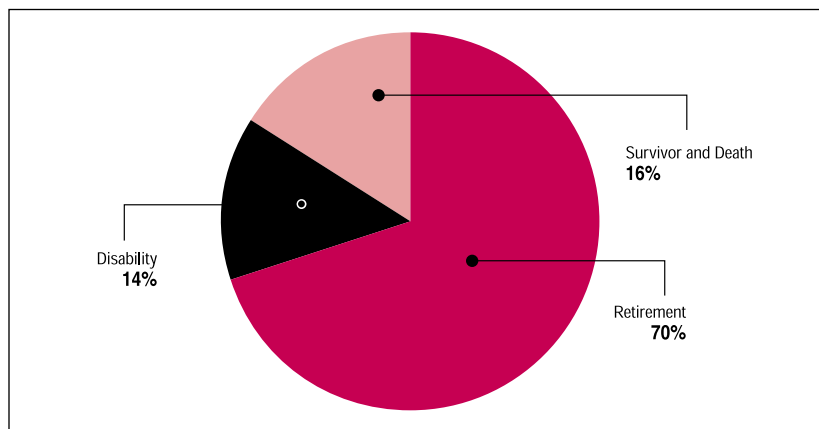
Death benefits represent 2 percent of the total number of CPP benefits paid and 1 percent

of the total benefit dollars paid out by the CPP in 2002-03. The death benefit is a one-time payment. The maximum payable is \$2,500; the average payment in March 2003 was \$2,201.49.

OTHER PROVISIONS

The CPP includes provisions that compensate for periods of low earnings, namely the child-rearing drop-out provision (CRDO) and the 15 percent general drop-out provision. The CRDO allows the CPP to drop up to seven years of low or zero earning (due to child rearing) from the calculation of a contributor's CPP disability, survivor and/or retirement benefit. The 15 percent general drop-out provision is for low or zero earning years and applies to all contributors. The Plan has other provisions under which married or common-law spouses may either share their pension credits where the union is intact, or split their credits where the union has dissolved. If you wish to know more about these, see our contact information on the inside front cover of this report.

Figure 2 – PERCENTAGE OF BENEFIT DOLLARS PAID FOR 2002-03



Improved Service Delivery

REACHING OUT TO CANADIANS

During 2002-03, HRDC continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings.

Personalized contact with clients continued to receive high priority. In 2002-03, HRDC issued personal CPP Statements of Contributions to more than 4.3 million contributors between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

DELIVERING SERVICE

In 2002-03, HRDC focused on maintaining the CPP information technology systems and continuing to modernize CPP program delivery in conjunction with information technology renewal.

Major systems-related initiatives gave CPP staff better online access to contributors' record-of-earnings information and the ability to correct client information online.

New data storage and retrieval features have been added to improve support to external partners, such as provincial social services departments and workers' compensation boards. These changes have improved client service and the speed with which benefits can be adjudicated and inquiries answered.

Work also continues on the rules-based system – a knowledge base to guide the decision-making process and ensure that legislation, operational policy and procedures are correctly and consistently applied.

PROCESSING BENEFITS

CPP services are offered in person, by telephone and by mail. In 2002-03, staff received 57,383 disability applications (which are complex and require medical information). These applications were processed within an average of 68 working days each. Other types of applications were processed within 26 days (see Table 1 below).

Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions. As a result, close to 90 percent of the applications for disability benefits in 2002-03 were finalized in the initial stages.

TABLE 1 – SPEED OF PROCESSING NEW APPLICATIONS

National speed-of-service measures	Objective	2002-03 National Average
Number of working days to process initial CPP applications* (excluding disability applications)	28	26
Number of working days to process initial CPP disability applications	62	68

*Number of days between the date the application is received and the date of the decision.

HRDC call centres received over 2 million calls about the CPP in 2002-03. Positive responses to the mail-out of personalized statements to CPP contributors and inquiries during the traditionally busy T4 period contributed to the high number of calls. Despite higher call volumes, service to clients

improved. In 2002-03, enhanced call management allowed for improved telephone service. Results show in the reduction of client waiting time and a significant increase in the speed of service.

TABLE 2 – TELEPHONE SERVICE STATISTICS*

	2001-02	2002-03
Percentage of clients served by a service agent within 180 seconds of placing a call**	81.9%	96.3%
Average waiting time to speak with a service agent	61 sec.	20 sec.
Average time clients spend talking to a service agent	244 sec.	237 sec.

* Table includes CPP and Old Age Security totals. Speed of service does not vary between programs.

** The objective is to serve clients within 180 seconds for 95 percent of calls.



Managing the CPP

COLLECTING AND RECORDING CONTRIBUTIONS

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is \$3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2003, was \$39,900 (up from \$39,100 in 2002). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rates for the year 2003 are 4.95 percent for employees and 4.95 percent for employers. People who are self-employed pay both portions, for a total of 9.9 percent. Employers and employees make approximately 94 percent of contributions and the remaining 6 percent comes from the self-employed.

All CPP contributions are remitted to the Canada Customs and Revenue Agency (CCRA). In 2002-03, contributions amounted to \$25.2 billion.

CCRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CCRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2002-03, CCRA conducted 64,278 audits, concentrating on files with irregularities.

ADMINISTRATIVE COSTS

In 2002-03, it cost approximately \$422 million to administer the CPP, with HRDC accounting for the largest portion – \$328 million (see Table 3 on page 19). CCRA required approximately \$80 million and Public Works and Government Services Canada (PWGSC) \$13 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, and the Department of Finance incurred costs of \$993,000 and about \$500,000, respectively.

Since the administrative costs of the CPP are drawn from CPP investment income, they are reported in that organization's annual report. This is consistent with the arm's-length administration of the Board. In 2002-03, the CPP reported \$12.9 million in investment and administrative expenses.

CPP administrative expenses in 2002-03 represent 1.95 percent of the \$21.6 billion in benefits paid. This ratio compares very favourably with that of other pension plans. Administrative costs, for example, average 5 percent of expenditures for large pension plans in the private sector that operate under a trust agreement. These tend to be the larger private plans in terms of both membership and asset size. CPP administrative costs also compare favourably with those of RRSPs.

Table 3 presents the CPP's administrative expenditures for the last three years.



TABLE 3 – CPP ADMINISTRATIVE COSTS 2000-01 TO 2002-03

Department/Agency	Expenditures (in \$ thousands)		
	2000-01	2001-02	2002-03
Human Resources Development Canada	\$242,562	\$279,156	\$328,268
Canada Customs and Revenue Agency	77,746	77,618	80,229
Public Works and Government Services Canada	12,810	12,440	12,823
Office of the Superintendent of Financial Institutions	1,102	1,061*	993*
Finance Canada	395	492	495
Total	\$334,615	\$370,767	\$422,808

* Amounts reflect actual expenses attributable to each fiscal year.

THE APPEALS PROCESS

There are three opportunities for review of a person's CPP benefit application (as shown on page 20). Most requests for review concern an application for disability benefits.

The first involves a request to the Minister of Human Resources Development for a reconsideration (or administrative review) of a decision concerning a benefit or a division of pension credits. The number of requests for reconsideration in disability cases declined slightly from 12,649 in 2000-01 to 12,092 in 2001-02, but increased slightly to 12,461 in 2002-03. The number of benefits awarded at reconsideration remained relatively unchanged from 2001-02 to 2002-03, declining from 28 percent to 27 percent.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is

an independent, impartial body made up of three people chosen by the Commissioner of Review Tribunals from a panel of some 300 part-time members appointed by Cabinet. The Review Tribunal heard 5,182 appeals during 2002-03. The grant rate at the Review Tribunal level was 48 percent in 2002-03.

The final opportunity for review is the Pension Appeals Board (PAB) – a tribunal operating at arm's length from HRDC. Board members are judges or former judges of the federal court or a superior court of a province. Hearings are not automatic at this level; claimants or the Minister of Human Resources Development must request "leave to appeal". Of the 1,219 applications for leave to appeal received in 2002-03, some 95 percent concerned CPP disability benefits. In 2002-03, some 62 percent of the applications received by the PAB were granted.

THE APPEALS PROCESS

INITIAL DECISION

Human Resources Development Canada (HRDC) issues a decision on CPP benefit eligibility.

If the client is not satisfied with the decision, he or she can submit a request for reconsideration to the Minister of Human Resources Development.

FIRST LEVEL OF REVIEW Review of client file and decision issued by HRDC

If the client is not satisfied with the decision, he or she has 90 days to appeal to the Office of the Commissioner of Review Tribunals.

SECOND LEVEL OF REVIEW Appeal to the Office of the Commissioner of Review Tribunals

The case is heard and a decision is issued.

If either the client or HRDC is not satisfied with the decision, an application for "Leave to Appeal" may be submitted to the Pension Appeals Board.

THIRD LEVEL OF REVIEW Appeal to the Pension Appeals Board

If leave is granted, the case is heard and a decision is issued.

The decision of the Pension Appeals Board is final, subject to judicial review by the Federal Court of Canada.

HRDC continues to work with the Office of the Commissioner of Review Tribunals and the Pension Appeals Board to improve co-ordination and response times and to identify opportunities for the earliest possible resolution of appeals.





Looking to the Future

Some 300,000 new CPP applications are received each year and a significant increase is expected as our population ages. The challenge will be to improve service delivery to ensure that Canadians continue to receive timely, accurate and client-focused service. Long-term initiatives aimed at meeting that challenge are now underway.

CPP ONLINE

CPP Online will support the objectives of the federal Government On-Line (GOL) initiative (the commitment to provide Canadians with full electronic access to key federal information and services by 2005). CPP Online initiatives include the implementation of a Web-based system that allows a wider range of inquiries and client transactions online. Six client groups – seniors, persons with disabilities, survivors, migrants, low-income pensioners, and contributors – will be the focal point for modernizing CPP service delivery over the decade. In this context, the importance of strengthening our technological framework is clear, especially since the fastest-growing group of Internet users is the seniors' population.

HRDC has made it a priority to update the systems that help deliver benefits. Evolving over the next four years, the systems will support better decision making by improving the information available to management, clients and staff through faster and more up-to-date technology. The improvements will further reduce the paper burden and the complexity of the application process.

Putting CPP information online is a multi-year project designed to provide Canadians with online access to information, data, and services essential to income security and retirement planning. A com-

prehensive review of legislation, regulations, policies, and procedures will lay the groundwork for an innovative, leading-edge approach to online services.

ONLINE SERVICES

Over the next two years, HRDC will offer a number of online service options for access to information and services that are essential to income security and retirement. These services will include:

Self-service options by Internet

In 2004, CPP clients will have secure online access to their personal information. They will be able to view and update their address and direct-deposit information online. The enhancement of these capabilities will continue, allowing more information to be viewed and updated in coming years.

Streamlined and automated CPP Statement of Contributions

CPP contributors can now submit an online request to receive a copy of their Statement of Contributions by mail. In 2004, they will be able to view Statement of Contributions information online.

Tax Information Slips Online

As of early 2004, CPP clients can view their CPP T4 slips online, starting with those for the 2003 taxation year.

SIMPLIFYING THE APPLICATION PROCESS

Simplifying the application process for the CPP retirement pension is part of HRDC's planned service delivery improvements. The goal is to make the application process easier for clients through streamlined, client-driven and more effective services.



Making it easier to apply for the CPP retirement pension will be the first step in building a modern service system that is based on Canadians' needs and expectations. It will reduce the need for complex information and documentation, replacing them with online applications. As part of this initiative, services allowing clients to apply for benefits online are being introduced.

Since July 2003, a simplified CPP retirement application has been available for clients to fill out online. Currently, they are required to print, sign and mail this form to HRDC along with their birth evidence. Efforts will be made to take the onus off clients for providing documentation such as birth certificates.

REACHING ALL CANADIANS

HRDC's programs help millions of people in Canada every day. The Department's primary objective is that every Canadian receive the benefits to which he or she is entitled under its programs.

There has been a dramatic decline in the low-income rate among Canadian seniors in recent decades. This is due in large part to the existence of public pensions such as the CPP.



Over the past several years, HRDC has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their own retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

The Internet has a tremendous ability to reach Canadians. HRDC leads the development of a cross-departmental Web site called Canada Benefits (www.canadabenefits.gc.ca). The site's mandate is to provide central access to government-wide financial benefit programs for individuals.

The Canada Benefits site provides information and lists services such as pensions, employment insurance and housing. The information and services are from federal, provincial and territorial government departments, Crown corporations and agencies. The award-winning Web site supports the "citizen-first" principle – information is organized for and made available to Canadians who need it.

Since its update in January 2003, the Canada Benefits site has experienced significant success, receiving an average of 48,000 visitors monthly. Initially launched in November 2001 with federal information, the site was expanded in January 2003 to include links to provincial and territorial information. A tool called the "Benefits Finder" provides citizens with a listing of programs relevant to their circumstances.

Through the Canada Benefits site and other means of communication, HRDC has been able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, HRDC strives to make them aware of the benefits available and helps them obtain those to which they are entitled.



Canada Pension Plan

Financial Statements

for the year ended March 31, 2003

Management's responsibility for financial statements

The financial statements of the Canada Pension Plan have been prepared by management of Human Resources Development Canada in accordance with the Canadian generally accepted accounting principles.

Management is responsible for the integrity and objectivity of the data in these financial statements, including the amounts which must, of necessity, be based on best estimates and judgements. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibility, management has developed and maintains books of account, financial and management controls, information systems and management practices. These are designed to provide reasonable assurance as to the reliability of the financial information, and to ensure that the transactions are in accordance with the *Canada Pension Plan* and regulations, as well as the *Financial Administration Act* and regulations.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Human Resources Development Canada.

Assistant Deputy Minister
Financial and Administrative Services

Associate Deputy Minister

Janet Milne



Maryantonett Flumian

October 1st, 2003



AUDITOR GENERAL OF CANADA

VERIFICATEUR GÉNÉRAL DU CANADA

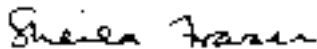
AUDITOR'S REPORT

To the Minister of Human Resources Development Canada

I have audited the statement of net assets of the Canada Pension Plan as at March 31, 2003 and the statement of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Human Resources Development Canada. 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 Canada Pension Plan as at March 31, 2003 and the changes in its net assets and its cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.



Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
October 1st, 2003

Statement of Net Assets

as at March 31

	2003	2002
		Restated (Note 4)
		(in millions of dollars)
Assets		
Investments		
CPP Investment Fund – at cost (Note 5)		
Provincial and Territorial bonds	23,204	24,890
Canada bonds	3,369	3,386
CPP Investment Board – at fair value (Note 6)	17,453	14,289
Cash		
Deposit with Receiver General for Canada	7,093	6,770
Receivables		
Contributions	1,631	1,378
Accrued interest	939	1,030
Régime des rentes du Québec	66	25
Beneficiaries (Note 7)	49	43
	53,804	51,811
Liabilities		
Accounts payable	74	47
Accrued pensions and benefits	55	51
CPP Investment Board's liabilities, net of its other assets	2	4
	131	102
Net Assets	53,673	51,709
Net Assets, represented by:		
Canada Pension Plan Investment Fund	26,573	28,276
Accumulated transfers to Canada Pension Plan Investment Board	21,690	14,372
Accumulated net loss from Investment Board's operations	(4,239)	(87)
Canada Pension Plan Account (Note 8)	7,093	6,770
CPP receivables, net of liabilities	2,556	2,378
Net Assets	53,673	51,709

The accompanying notes are an integral part of these financial statements.

Approved by Human Resources Development Canada:

Assistant Deputy Minister
Financial and Administrative Services

Associate Deputy Minister

Janet Milne



Maryantonett Flumian



Statement of Changes in Net Assets

for the year ended March 31

	2003	2002
		Restated (Note 4)
	(in millions of dollars)	
Net assets, beginning of year	51,709	46,014
Increase in assets		
Contributions (Note 9)	25,203	22,991
Investment Income / (loss) (Note 10)	(1,242)	3,565
	23,961	26,556
Decrease in assets		
Pensions and Benefits		
Retirement	15,071	14,270
Survivors	3,071	2,933
Disability	2,779	2,641
Disabled Contributor's Child	251	242
Death	234	227
Orphan	210	205
Net overpayments	(41)	(28)
	21,575	20,490
Administration costs (Note 11)	422	371
	21,997	20,861
Increase in net assets	1,964	5,695
Net assets, end of year	53,673	51,709

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flow

for the year ended March 31

	2003	2002
	(in millions of dollars)	
Cash Flow Provided by Operating Activities		
Cash Receipts:		
Contributions	24,950	23,354
Interest from CPP Investment Fund	2,839	3,166
Interest on Deposit with Receiver General for Canada	163	202
Recoveries from Régime des rentes du Québec	192	214
Recoveries from beneficiaries	37	32
	28,181	26,968
Cash Payments:		
Pensions and Benefits	(21,613)	(20,516)
Repayments to Régime des rentes du Québec	(235)	(217)
Administration costs	(395)	(375)
	(22,243)	(21,108)
	5,938	5,860
Cash Flow From (Used in) Investing Activities		
Transfers to CPP Investment Board	(7,318)	(6,826)
Disposals of bonds – CPP Investment Fund	2,383	2,369
Reinvestments in bonds – CPP Investment Fund	(680)	(1,053)
	(5,615)	(5,510)
Net increase in the Deposit with Receiver General for Canada	323	350
Deposit with Receiver General for Canada, beginning of year	6,770	6,420
Deposit with Receiver General for Canada, end of year	7,093	6,770

The accompanying notes are an integral part of these financial statements.



Notes to financial statements March 31, 2003

1. DESCRIPTION OF THE CANADA PENSION PLAN

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Human Resources Development Canada is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are responsible for setting CPP contribution rates, pension and benefit levels and funding policy.

The financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 8). The CPP Investment Fund (Note 5) holds the bond portfolio of the Plan, and the Plan's investments in capital markets are managed by the CPP Investment Board (Note 6). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations.

As stated in the CPP Act, changes to this Act require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

CPP is financed by contributions and investment returns.

Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis – that is, combined contributions increased to 9.9% of pensionable earnings in 2003 and are expected to level off.

From 1966 to 1986, the combined employer-employee contribution rate remained at 3.6% of pensionable earnings. In 1987, it was raised to 3.8% and increased yearly by 0.2% to reach 5.6% in 1996. In the years 1997 to 2002, the combined contribution rate was increased annually to reach 9.9% in 2003. The maximum combined contribution for 2003 was \$3,604 (2002 – \$3,346).

- **ANNUAL REPORT** of the Canada Pension Plan

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The *Eighteenth Actuarial Report* of the Chief Actuary of the Office of the Superintendent of Financial Institutions done as at December 31, 2000 was presented to the Minister of Finance in December 2001, then tabled in the House of Commons on December 10, 2001. Based on this report, federal and provincial ministers of Finance concluded at the end of the 2002 Triennial Review process that the CPP is financially sound and that the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population. A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the 18th CPP actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2003 is expected to be completed by December 2004.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada, short term investments, long term investments in bonds held by the CPP Investment Fund and investments managed by the CPP Investment Board. The net assets represent funds accumulated for the payment of pensions, benefits and administration costs. This amount does not cover the actuarial present value of accrued pensions and benefits. As at March 31, 2003, the net assets of the Plan are of \$53.7 billion (2002 – \$51.7 billion). This amount represents approximately 2.5 times the total of pensions and benefits for the year 2002-2003.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2003 is \$801.25 (2002 – \$788.75).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2003 is \$971.26 (2002 – \$956.05).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2003 is \$480.75 (2002 – \$473.25).



Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or who died is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2003 is \$186.71 (2002 – \$183.77).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2003 is \$2,500 (2002 – \$2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2003 is 1.6% (2002 – 3.0%).

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements present the financial position, the changes in net assets and the cash flows of the Canada Pension Plan. They include the financial position of the CPP Investment Board and the results of its operations. These financial statements are prepared in accordance with Canadian generally accepted accounting principles and conform to the disclosure and accounting requirements of the CPP Act.

These financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded.

The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments

Bonds are shown at cost, which is equal to the face value of the bonds at the time of purchase. This accounting policy has been selected based on the non-marketable, non-transferable nature of the bonds and on consideration of the likelihood of redemption of the provincial and territorial bonds in the foreseeable future. The bonds issued by the provincial and territorial governments are redeemable prior to maturity at market value equivalent at the option of these governments. In the event that the federal Minister of Finance considers the redemption necessary to pay pensions, benefits and administration costs, the bonds would then be redeemed at face value.



CPP Investment Board's investments are stated at fair value. Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Quoted market prices for publicly traded equities and unit values for pooled funds are used to represent fair value for the investments. Unit values reflect the quoted market prices of the underlying securities.

In the case of private equity investments, where quoted market prices are not available, fair value is determined annually, commencing after the first year of ownership, based on carrying values and other relevant information reported by external managers of the limited partnerships in which the investments are made. These carrying values are determined by the external managers using accepted industry valuation methods.

The fair value of private market investments in income producing properties is determined annually, commencing after the first year of ownership, using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions.

Fair value for the over-the-counter derivatives such as swaps is determined based on discounted cash flows and market prices for underlying assets with similar characteristics.

Money market securities are recorded at cost which, together with accrued interest income, approximates fair value.

- c) Contributions** to the Plan include CPP contributions for pensionable income earned and collected by the Canada Customs and Revenue Agency (CCRA) for the year and receivable at year-end. Contributions collected by the CCRA are measured from amounts assessed by the CCRA and from estimates of amounts not assessed based on cash received and are subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

Interest income is recorded in the year in which it is earned.

CPP Investment Board's net income from operations represents the Investment Board's investment income, less investment and administrative expenses. Investment income is recorded on the accrual basis and includes realized gains and losses on disposal or transfer of investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income, distributions from mutual and pooled funds, and net operating income from private market real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent the change year-over-year in the difference between fair value and cost of investments.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits are recorded when payable.

g) Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

h) Administration costs are recorded in the year to which they relate.

i) Measurement uncertainty

The preparation of financial statements in accordance with the Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and revenue and expenses for the year. Actual results could differ from these estimates. The most significant estimates are related to contributions, administration costs, allowance for doubtful accounts and the fair value of the bonds held by the CPP Investment Fund.

3. CHANGE IN BASIS OF ACCOUNTING

During the year, the CPP adopted Canadian generally accepted accounting principles as the basis of presentation of its financial statements.

This change resulted in the addition of a statement of cash flow to the existing set of financial statements.

4. CHANGE IN ACCOUNTING POLICY

During the year, the methodology used to measure contributions was changed to conform with the new assessment-based methodology developed by the Government of Canada for determining tax revenues, CPP contributions and Employment Insurance premiums. The new methodology is further described in Note 9.

Prior to 2002-2003, contributions were measured using an economic/statistical methodology developed by the Department of Finance including many factors such as the growth in the number of contributors and the average pensionable earnings.

This change in accounting policy has been applied retroactively and the 2001-2002 financial statements have been restated accordingly. The effect of the change for contributions on the current year and previous year's results is presented below:

Year ended and as at March 31	2003	2002
	(in millions of dollars)	
	Increase (Decrease)	
Statement of Changes in Net Assets		
Contributions	160	(542)
Net Assets	160	(542)
Net Assets, beginning of year	(216)	326
Net Assets, end of year	(56)	(216)
Statement of Net Assets		
Contribution receivables	(56)	(216)

5. INVESTMENTS HELD BY THE CPP INVESTMENT FUND

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

Until the end of 1997, the investments in provincial, territorial and federal government bonds were made with the cash on hand in excess of the Plan's forecast three-month operating requirement. These bonds were not marketable and had a 20-year term (or less) as fixed by the Minister of Finance on the recommendation of the Chief Actuary of the Office of the Superintendent of Financial Institutions. The interest rate on the bonds was determined by the Minister of Finance based on the average yield to maturity of all outstanding Government of Canada obligations with terms of 20 years or more. When these bonds matured, funds not required for payment of pensions and benefits were re-invested in new bonds.

Beginning in 1998, a maturing provincial or territorial bond may be re-invested in a new bond only once for a term of 20 years, if both the issuer asks to do so and the operating balance is sufficient to pay current pensions and benefits. Excess funds not re-invested are transferred to the CPP Investment Board.

The re-invested bonds remain not marketable and bear interest at a rate fixed by the Minister of Finance. The interest rate is substantially the same rate that the province would pay if it were to borrow the same amount for the same term through the issuance of a bond on the public capital markets. Interest earned on the investments is paid semi-annually to the CPP Account.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. Since January 31, 2001, the provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. The bonds can also be redeemed at the option of the federal Minister of Finance where he considers the redemption necessary to pay pensions, benefits and administration costs. The bonds are then redeemed at face value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2003.

At March 31, 2003, the balance in the Investment Fund was \$26.6 billion at cost (2002 – \$28.3 billion). The estimated fair value of the balance in the Investment Fund, including accrued interest, is \$32.6 billion (2002 – \$34.3 billion). This estimate is calculated by discounting the bonds' contractual cash flows at rates currently available at year-end for similar investments.

The following schedule provides information on the disposals, re-investments and balance of the Investment Fund.

Bonds, at cost

	(in millions of dollars)			
	March 31, 2002	Disposals	Re-Investments	March 31, 2003
Newfoundland	633	52	52	633
Prince Edward Island	140	11	11	140
Nova Scotia	1,173	94	–	1,079
New Brunswick	834	73	73	834
Quebec	96	5	5	96
Ontario	11,944	1,236	38	10,746
Manitoba	1,260	132	–	1,128
Saskatchewan	1,219	110	42	1,151
Alberta	3,560	275	100	3,385
British Columbia	4,027	378	359	4,008
Yukon Territory	4	–	–	4
	24,890	2,366	680	23,204
Canada	3,386	17	–	3,369
	28,276	2,383	680	26,573

The following schedule presents the bonds by maturity dates and the weighted-average annual rate of return on bonds currently held.

	2003		(in millions of dollars)		2002	
	Investments at cost	Average yield	Investments at cost	Average yield		
Investments maturing						
Within 1 year	2,499	11.77%	2,383	14.80%		
1 – 5 years	9,700	10.99%	10,020	11.46%		
Over 5 years	14,374	8.90%	15,873	9.13%		
Total – Investments	26,573		28,276			
Weighted-average yield on investments		9.93%			10.43%	



6. INVESTMENTS HELD BY THE CPP INVESTMENT BOARD

The Canada Pension Plan Investment Board (CPPIB) was established by an Act of Parliament in 1997. The *Canada Pension Plan Investment Board Act* came into force on April 1, 1998. The purpose of the Board is to invest the funds transferred by the CPP in a diversified portfolio of investments. The Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces and provides regular reports of its activities and the results achieved.

The following schedule provides information on the Board's investments as at March 31.

	2003	2002
	(in millions of dollars)	
Canadian equities, at fair value		
Public Markets	11,051	9,825
Private Markets	261	144
	11,312	9,969
Non-Canadian equities, at fair value		
Public Markets	4,245	3,832
Private Markets	1,265	316
	5,510	4,148
Total Equities (Cost 2003 – \$20,336; 2002 – \$14,546)	16,822	14,117
Real Return Assets		
Public markets real estate	219	145
Private markets real estate	246	–
Total Real Return Assets (Cost 2003 – \$645; 2002 – \$145)	465	145
Money Market Securities (Cost 2003 – \$575; 2002 – \$27)	575	27
Investment Receivables (Cost 2003 – \$41; 2002 – Nil)	41	–
Investment Liabilities (Cost 2003 – \$452; 2002 – Nil)	(450)	–
Total Net Investments	17,453	14,289

The CPP Investment Board has established investment policies which set out the manner in which assets shall be invested. In determining the asset mix, the CPPIB takes into consideration certain assets of the CPP which are held outside the CPP Investment Board.

In accordance with its Investment Policy, at least 70% of the book value of the CPP Investment Board's portfolio is allocated to Canadian investments and the remainder to non-Canadian investments.

The CPPIB's investments are mainly allocated to equities. During the current year, the CPP Investment Board sold units held in index pooled and mutual funds and purchased the individual securities underlying the funds. The CPP Investment Board also obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private real estate investments are held by a subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements.

The CPPIB limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts approved by the Board of Directors.

The CPP Investment Board is exposed to currency risk through holdings of non-Canadian investments and investment receivables. Investments are not hedged against changes in foreign exchange rates.

The CPP Investment Board is exempt from Part I tax under paragraph 149 (1) (d) of the *Income Tax Act (Canada)* on the basis that all of the shares of the CPP Investment Board are owned by Her Majesty in right of Canada. The CPP Investment Board's subsidiaries are exempt from Part I tax under paragraph 149(1)(d.2) of the *Income Tax Act (Canada)* on the basis that all of the shares of the subsidiaries are owned by a corporation whose shares are owned by Her Majesty in right of Canada.

The CPP Investment Board's audited financial statements for the year ended March 31, 2003 are publicly available and provide details concerning the Board's investment policy, its investments and portfolio return.



7. RECEIVABLES FROM BENEFICIARIES

	2003	2002
	(in millions of dollars)	
Balance of pensions and benefits overpayments	77	73
Allowance for doubtful accounts	(28)	(30)
	49	43

Human Resources Development Canada has procedures to detect overpayments. During the year, overpayments totalling \$45 million (2002 – \$38 million) were established and remissions of debts totalling \$4 million (2002 – \$10 million) were granted. A further \$37 million was recovered (2002 – \$32 million).

8. CANADA PENSION PLAN ACCOUNT

The CPP Account was established in the accounts of Canada by the CPP Act, to record the contributions, interest, pensions, benefits and administration costs of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

The balance of the CPP Account includes the Deposit with Receiver General for Canada and short-term investments, if any. As at March 31, the Deposit with Receiver General for Canada amounts to \$7,093 million (2002 – \$6,770 million).

9. CONTRIBUTIONS

As indicated in Note 4, contributions for the year are measured by Canada Customs and Revenue Agency (CCRA). Contributions are measured based on amounts assessed and reassessed by CCRA at the time of preparation of its financial statements and an estimate of contributions for the period that were not yet assessed or reassessed at that time based on cash amounts received.

Actual results may differ from these estimates. Actual contribution amounts for calendar years 2002 and 2003 will only be known once the CCRA has processed all employers' and self-employed workers' declarations of contributions for these years. An adjustment for the variation between actual and estimated contributions will be recorded in the fiscal year in which the adjustment is known.

10. INVESTMENT INCOME/(LOSS)

	2003	2002
	(in millions of dollars)	
Interest on bonds held by the CPP Investment Fund	2,741	3,071
Interest on deposit with the Receiver General for Canada at a weighted-average annual rate of 2.64% (2002 – 3.09%)	169	189
Investment Board net income/(loss) from operations:		
Net unrealized gains/(losses)	(3,264)	459
Fund distributions of capital gains and dividends	361	213
Net realized losses	(1,533)	(378)
Dividend Income	288	12
Other investment income	9	10
Investment and administrative expenses	(13)	(11)
	(4,152)	305
	(1,242)	3,565

11. ADMINISTRATION COSTS

	2003	2002
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services (Human Resources Development Canada)	328	279
Collection of contributions (Canada Customs and Revenue Agency)	80	78
Cheque issue and computer services (Public Works and Government Services Canada)	13	13
Actuarial services (Office of the Superintendent of Financial Institutions)	1	1
	422	371

Administration costs of the CPP represent the cost of services received from a number of federal government departments and an agency. Those costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding.



12. CONTINGENCIES

At March 31, 2003, there were 5,140 (8,185 in 2002) appeals relating to the payment of CPP pensions and benefits. Claims for these appeals could reach a maximum estimated amount of \$22 million (\$35 million in 2002). Any award made in favour of beneficiaries will be accounted for as an expenditure of the period in which the amount becomes payable.

13. LEGISLATIVE AMENDMENT

Legislation to amend the Canada Pension Plan and the *Canada Pension Plan Investment Board Act* was passed by Parliament on April 3, 2003, and is now subject to provincial approval. The provisions of the amending legislation contemplate a transfer of the CPP assets currently managed by the federal government to the CPP Investment Board. These assets consist of the bonds held by the CPP Investment Fund and the Deposit with Receiver General for Canada. If the legislative change is approved by the provinces, these assets will be transferred over a period of three years.

14. COMPARATIVE FIGURES

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



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