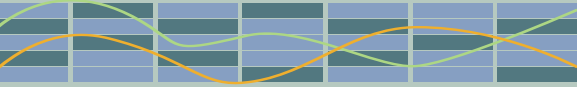


# Financial Statements and Notes to the Financial Statements



## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The financial statements of the Public Sector Pension Investment Board ("PSP Investments") have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Management is responsible for the contents of the financial statements and the financial information contained in the annual report.

PSP Investments maintains records and systems of internal control and supporting procedures to provide reasonable assurance that PSP Investments' assets are safeguarded and controlled, and that transactions are in accordance with the *Public Sector Pension Investment Board Act*, the accompanying regulations, the by-laws, and the Statement of Investment Policies, Standards and Procedures.

The Audit and Conflicts Committee assists the Board of Directors in discharging its responsibility to approve the annual financial statements. The Committee meets regularly with both management and the external auditors to discuss the scope and findings of audits and other work that the external auditors may be requested to perform from time to time, to review financial information, and to discuss the adequacy of internal controls. The Committee reviews the annual financial statements and recommends them to the Board of Directors for approval.

PSP Investments' external auditors, Deloitte & Touche LLP, have conducted an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an opinion in their Auditors' Report. The external auditors have full and unrestricted access to management and the Audit and Conflicts Committee to discuss findings related to the integrity of PSP Investments' financial reporting and the adequacy of internal control systems.



**Paul G. Haggis**  
Director and Chair of the Management Committee  
May 8, 2003



**Danielle G. Morin**  
Chief Financial Officer  
May 8, 2003

## INVESTMENT CERTIFICATE

*The Public Sector Pension Investment Board Act* (the "Act") requires that a certificate be signed by a director on behalf of the Board of Directors, stating that the investments of the Public Sector Pension Investment Board ("PSP Investments") held during the year were in accordance with the *Act* and PSP Investments' investment policies, standards and procedures. Accordingly, the Investment Certificate follows:

*"The investments of PSP Investments held during the year ended March 31, 2003, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures."*



**Paul Cantor**  
Chairperson  
May 8, 2003

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Auditors' Report**

To the Board of Directors of  
Public Sector Pension Investment Board

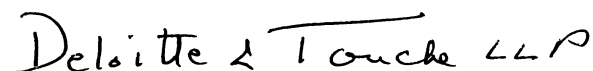
We have audited the Balance Sheet and the Statement of Investment Portfolio of the Public Sector Pension Investment Board ("PSP Investments") as at March 31, 2003 and the Statements of Net Income (Loss) from Operations and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of PSP Investments management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these financial statements present fairly, in all material respects, the financial position of PSP Investments and the investments held as at March 31, 2003 and the results of its operations and of changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Further, in our opinion, the transactions of PSP Investments that have come to our attention during our audit of the financial statements, have, in all significant respects, been in accordance with the *Public Sector Pension Investment Board Act* (the "Act") and the by-laws.

Further, in our opinion, the record of investments kept by PSP Investments' management pursuant to paragraph 35 (1) (c) of the *Act* fairly presents, in all material respects, the information required by the *Act*.



Chartered Accountants

Montréal, Québec  
May 1, 2003

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Balance Sheet***As at March 31*

	2003 (\$,000)	2002 (\$,000)
<b>ASSETS</b>		
Investments - at fair value (Note 2)	8,101,641	5,623,975
Cash	—	24,633
Other assets (Note 3)	2,031	264
	<b>8,103,672</b>	<b>5,648,872</b>
<b>LIABILITIES</b>		
Bank overdraft (Note 4)	2,973	—
Accounts payable and accrued liabilities	4,987	2,233
	<b>7,960</b>	<b>2,233</b>
<b>NET ASSETS</b>	<b>8,095,712</b>	<b>5,646,639</b>
<b>NET ASSETS REPRESENTED BY</b>		
Public Service Pension Plan Account	5,756,832	3,975,216
Canadian Forces Pension Plan Account	1,723,935	1,236,048
Royal Canadian Mounted Police Pension Plan Account	614,945	435,375
	<b>8,095,712</b>	<b>5,646,639</b>

On behalf of the Board of Directors:



Keith Martell  
Director and Chair of the Audit and Conflicts Committee

**Statement of Changes in Net Assets***For the year ended March 31*

	2003 (\$,000)	2002 (\$,000)
NET ASSETS, BEGINNING OF YEAR	5,646,639	2,510,768
<b>CHANGES IN NET ASSETS</b>		
Fund transfers (Note 5)	3,382,074	2,996,362
Net income (loss) from operations	(933,001)	139,509
<b>NET ASSETS, END OF YEAR</b>	<b>8,095,712</b>	<b>5,646,639</b>

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Statement of Net Income (Loss) from Operations**

For the year ended March 31

	2003 (\$,000)	2002 (\$,000)
<b>INVESTMENT INCOME AND GAINS (LOSSES)</b>		
Interest and dividends	247,218	125,190
Net realized gains (losses) (Note 7)	(163,819)	(412,404)
Change in unrealized appreciation (depreciation) in value of investments	(1,003,410)	434,009
	<b>(920,011)</b>	<b>146,795</b>
<b>EXPENSES</b>		
Operating expenses (Note 8a)	8,997	6,535
External investment management fees	3,993	751
	<b>12,990</b>	<b>7,286</b>
<b>NET INCOME (LOSS) FROM OPERATIONS</b> (Note 9)	<b>(933,001)</b>	<b>139,509</b>

**Statement of Investment Portfolio**

As at March 31

	2003			2002		
	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)	Cost (\$,000)	Fair Value (\$,000)	% of Portfolio (At Fair Value)
Investments (Note 2)						
<b>CANADIAN EQUITIES</b>						
PSP Canadian Equities Fund						
Active management	1,599,043	1,478,865	18.2	221,627	224,310	4.0
Indexed management	1,885,369	1,683,141	20.8	1,601,915	1,754,314	31.2
	<b>3,484,412</b>	<b>3,162,006</b>	<b>39.0</b>	<b>1,823,542</b>	<b>1,978,624</b>	<b>35.2</b>
<b>FOREIGN EQUITIES</b>						
PSP Foreign Equities Fund						
Active management	1,361,247	1,164,159	14.4	354,428	365,527	6.5
Indexed management	1,174,264	916,272	11.3	1,264,202	1,325,799	23.5
	<b>2,535,511</b>	<b>2,080,431</b>	<b>25.7</b>	<b>1,618,630</b>	<b>1,691,326</b>	<b>30.0</b>
<b>FIXED INCOME</b>						
PSP Fixed Income Fund						
Active management	1,273,561	1,285,882	15.9	1,174,030	1,175,227	20.9
Indexed management	1,363,255	1,328,868	16.4	636,317	611,200	10.9
	<b>2,636,816</b>	<b>2,614,750</b>	<b>32.3</b>	<b>1,810,347</b>	<b>1,786,427</b>	<b>31.8</b>
<b>CASH EQUIVALENTS</b>						
PSP Cash Equivalents Fund	244,454	244,454	3.0	167,598	167,598	3.0
	<b>8,901,193*</b>	<b>8,101,641*</b>	<b>100.0%</b>	<b>5,420,117*</b>	<b>5,623,975*</b>	<b>100.0%</b>

\* Includes investment receivables of \$57.5 million (2002 - \$81.2 million) and investment payables of \$83.4 million (2002 - \$84.1 million) pertaining to pending trades for a net payable of \$25.9 million (2002 - \$2.9 million).

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements**

For the year ended March 31, 2003

**ORGANIZATION**

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* (the "Act") with a mandate to invest in financial markets the contributions to the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans. Prior to the implementation of the provisions of the Act, the balances of the plans were credited with a rate of interest based on long-term Government of Canada bonds.

The Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds were established by amendments to the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* and the *Royal Canadian Mounted Police Superannuation Act* ("the Superannuation Acts"), to receive contributions and make benefit payments in respect of member service after April 1, 2000. The excess of contributions over benefits is transferred, by each Pension Fund, to their respective PSP Investments-Plan Account for investment.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The amounts are to be invested with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*.

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Basis of presentation**

These financial statements present the financial position and operations of PSP Investments as they pertain to the investment of the excess funds transferred to it from the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. Accordingly, they do not reflect all of the assets, or the details of the pension contributions, payments and liabilities of all three Pension Funds. The statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Act.

**Plan Accounts**

PSP Investments maintains records of each Pension Funds' net contributions, as well as, the allocation of its investments and the results of its operations to each of the Plan Accounts.

Separate financial statements for each Plan Account have been published.

**Valuation of investments**

Investments are recorded as of the trade date and 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.

Fair values of investments are determined as follows:

- (a) Short-term deposits are recorded at cost which, together with accrued interest income, approximates fair value.
- (b) Market prices for equities and unit values for pooled funds are used to represent the fair value of investments. Unit values reflect the quoted market prices of the underlying securities.
- (c) Fixed Income securities are valued at year-end quoted market prices where available. Where quoted market prices are not available, estimated values are calculated using an appropriate interest rate curve with a spread associated with the credit quality of the issuer.

**Income recognition**

Investment income is recorded on the accrual basis and represents realized gains and losses on the disposal of investments, change in unrealized appreciation (depreciation) on investments held at the end of the year, interest income and dividends. These income items include the related distributions from pooled funds.

**Translation of foreign currencies**

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

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements**

For the year ended March 31, 2003

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Fund transfers**

Amounts received from each Pension Fund are recorded on a cash basis in their respective Plan Account.

**Income Taxes**

PSP Investments is exempt from Part I tax under paragraph 149(1)(d) of the *Income Tax Act* (Canada).

**Use of estimates**

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, related income and expenses and note disclosures. Actual results may differ from estimates.

**2. INVESTMENTS**

The Statement of Investment Portfolio provides details of investments held as at March 31, 2003.

**(a) Investment Policy**

PSP Investments has established a Statement of Investment Policies, Standards and Procedures, (the "Investment Policy") which sets out the manner in which the assets shall be invested for the three Plan Accounts. Asset mix policy and benchmarks as at March 31, 2003 were as follows:

Asset Class	Policy Mix	Benchmark
Canadian Equities	35.0%	S&P/TSX
Foreign Equities	30.0%	S&P 500, MSCI EAFE
Fixed Income	32.0%	SC Bond Universe
Cash Equivalents	3.0%	SC 91-day T-bill

Effective April 1<sup>st</sup> 2003, an amendment to the Investment Policy enables PSP Investments to hedge part of the foreign currency exposure.

**(b) Foreign currency exposure**

PSP Investments is exposed to currency risk through holdings of securities and units in pooled funds of non-Canadian equities where investment values will fluctuate due to changes in foreign exchange rates. The underlying foreign currency exposures by currency as at March 31 were as follows:

Currency	2003		2002	
	Fair Value (\$,000)	% of Total	Fair Value (\$,000)	% of Total
US Dollars	1,223,964	58.9	971,426	57.4
Euro	315,711	15.2	270,284	16.0
British Pound	197,733	9.5	178,971	10.6
Yen	176,794	8.5	147,377	8.7
Others	164,628	7.9	123,268	7.3
	<b>2,078,830</b>	<b>100.0%</b>	1,691,326	100.0%

In accordance with the Investment Policy, foreign currency exposures are not hedged.

The fair value of PSP Foreign Equities Fund includes \$1,601 thousand of Canadian dollars (2002 - Nil) which are not included in the foreign currency exposure.

In April 2003, a program was initiated to hedge up to 50% of the fair value of all US dollar denominated investments held in the PSP Foreign Equities Fund.

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements**

For the year ended March 31, 2003

**2. INVESTMENTS (continued)****(c) PSP Canadian Equities Fund – 10 largest holdings**

Company Name		Fair Value (\$,000)	% of PSP Canadian Equities Fund
1	Royal Bank of Canada	214,061	6.8
2	Bank of Nova Scotia	160,955	5.1
3	Encana Corporation	130,589	4.1
4	Toronto Dominion Bank	116,426	3.7
5	BCE Inc.	115,333	3.6
6	Bank of Montreal	108,614	3.4
7	Petro Canada	82,217	2.6
8	Sun Life Financial Services of Canada Inc.	80,615	2.5
9	Transcanada Pipelines	75,699	2.4
10	Barrick Gold Corporation	74,357	2.4
<b>Total 10 largest Holdings</b>		<b>1,158,866</b>	<b>36.6%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

**(d) PSP Foreign Equities Fund – 10 largest holdings**

Company Name		Fair Value (\$,000)	% of PSP Foreign Equities Fund
1	Citigroup Inc.	37,486	1.8
2	Exxon Mobil Corporation	33,765	1.6
3	Microsoft Corporation	33,417	1.6
4	General Electric Company	33,241	1.6
5	Pfizer Inc.	31,389	1.5
6	Vodafone Group Plc	31,324	1.5
7	Wal-Mart Stores Inc.	29,810	1.4
8	Royal Dutch Petroleum Company	24,587	1.2
9	United Health Group Inc.	22,982	1.1
10	Johnson & Johnson	22,756	1.1
<b>Total 10 largest Holdings</b>		<b>300,757</b>	<b>14.4%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.

**(e) PSP Fixed Income Fund**

The PSP Fixed Income Fund holds securities invested in Canada as follows:

	Fair Value (\$,000)	% of PSP Fixed Income Fund
Government of Canada	1,045,201	40.0
Provincial	575,375	22.0
Municipal	3,860	0.1
Corporate	987,234	37.8
Cash	3,080	0.1
<b>Total of PSP Fixed Income Fund</b>	<b>2,614,750</b>	<b>100.0%</b>

Some of the holdings shown above are held through Indexed Pooled Fund participation.



## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements**

For the year ended March 31, 2003

**3. OTHER ASSETS**

Other assets as at March 31 consist of the following:

	2003	2002
	(\$,000)	(\$,000)
Accrued Income	—	17
Fixed assets	1,287	—
Other assets	744	247
	<b>2,031</b>	264

**4. BANK OVERDRAFT**

The bank overdraft is an infrequent occurrence and arises from temporary requirements to settle security purchases prior to receiving the contribution from one of the Pension Funds. The amount is repaid within two business days.

**5. FUND TRANSFERS**

During the year, PSP Investments received \$3,382.1 million (2002 - \$2,996.3 million) of transfers from the three Pension Funds. The transfers result from net current employer and employee contributions to their respective Pension Plan.

The breakdown of the fund transfers for the year ended March 31 is as follows:

	2003	2002
	(\$,000)	(\$,000)
Public Service Pension Fund	2,442,872	2,086,332
Canadian Forces Pension Fund	687,973	674,012
Royal Canadian Mounted Police Pension Fund	251,229	236,018
Total Fund Transfers	<b>3,382,074</b>	2,996,362

**6. INVESTMENT PERFORMANCE**

Portfolio and benchmark returns for the year ended March 31 were as follows:

	2003		2002		
	Portfolio Returns	Benchmark Returns	Portfolio Returns	Benchmark Returns	
Canadian Equities	(18.6)%	(17.6)%	4.7%	4.9%	S&P/TSX
Foreign Equities	(30.5)%	(29.9)%	(3.3)%	(2.6)%	S&P 500 & MSCI EAFE
Fixed Income	9.4%	9.2%	5.3%	5.1%	SC Bond Universe
Cash Equivalents	3.2%	2.7%	4.0%	3.7%	SC 91-day T-bill
Total Return	(13.5)%	(12.9)%	2.7%	2.8%	

The total benchmark return aggregates the asset class benchmark returns according to the weights specified in the Investment Policy, as disclosed in Note 2 (a).

Returns have been calculated in accordance with the mandatory requirements set forth by the Association for Investment Management and Research (AIMR). Returns are presented gross of expenses.

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements***For the year ended March 31, 2003***7. NET REALIZED GAINS (LOSSES)**

The realized losses of \$163,819 thousand (2002 – losses of \$412,404 thousand) includes foreign currency gains of \$1,425 thousand (2002 – losses of \$1,408 thousand).

On October 2nd 2001, PSP Investments created the PSP Funds and the units in SSgA pooled funds previously held in the name of the three Plan Accounts, were transferred to the PSP Funds. This deemed disposition caused previously *Change in unrealized depreciation in value of investments* to become realized losses in the *Statement of Net Income (Loss) and Accumulated Net Income (Loss) from Operations* for the three Plan Accounts. This had no impact on the Plan Accounts, except for bringing the investments cost values closer to their fair values at that time.

**8. EXPENSES****(a) Operating expenses**

Operating expenses consist of the following:

	2003	2002
	(\$,000)	(\$,000)
Salaries and benefits	4,544	2,756
Office supplies and equipment	1,364	996
Professional and consulting fees	1,273	1,491
Occupancy costs	570	336
Remuneration earned by Directors	425	339
Custody and fund administration	351	116
Communication expenses	151	248
Travel and accommodation for Director's meetings	150	160
Depreciation of fixed assets	105	—
Other operating expenses	64	93
	<b>8,997</b>	<b>6,535</b>

Total remuneration earned by Directors includes 1) an annual retainer of \$40,000 for the Board Chairperson and of \$16,000 for each Director; 2) an annual retainer of \$5,000 for each committee chair; 3) Board and committee meeting fees of \$1,000 per meeting and; 4) a travel time meeting fee of \$1,000 if distance to and from the meeting is greater than 1,000 km from the director's primary residence. Separate fees are not paid for Investment Committee meetings when they are held as a committee of the whole during Board meetings. The Board Chairperson is not eligible for committee meeting fees.

Directors of PSP Investments come from various regions of the country and accordingly they incur travel and accommodation expenses in attending meetings of the Board and committees.

## PUBLIC SECTOR PENSION INVESTMENT BOARD

**Notes to the Financial Statements**

For the year ended March 31, 2003

**8. EXPENSES (continued)****(b) Salaries and benefits**

Included in salaries and benefits is compensation earned by executive officers. The total compensation earned during the fiscal year by the executive officers was as follows:

Employee / Position	Year	Annual Base Salary (\$)	Annual Bonus <sup>3</sup> (\$)	Long Term Incentive Plan <sup>3</sup> (\$)	Benefits <sup>4</sup> (\$)
Adel Sarwat <sup>1</sup> President and Chief Executive Officer	2003	305,000	45,800	—	47,000
	2002	275,000	143,000	213,000	50,500
Danielle G. Morin <sup>2</sup> Chief Financial Officer	2003	195,000	88,800	—	29,000
	2002	181,400	82,600	53,500	26,800

<sup>1</sup> The President and Chief Executive Officer left PSP Investments on March 20, 2003 and is entitled to receive \$886,000 of compensation. In addition, PSP Investments covered the expenses related to his departure.

<sup>2</sup> The Chief Financial Officer commenced employment on April 6, 2001, and in addition to the above, was awarded a signing bonus of \$30,000 in fiscal year 2002.

<sup>3</sup> Bonus awards include short-term and long-term components and are based on the achievement of agreed objectives. PSP Investments has established a new program for the long-term bonus which was implemented this year. Consequently, a long term bonus for fiscal year 2002 has been paid to close the previous program.

<sup>4</sup> Benefits include other miscellaneous non-cash remuneration. For fiscal year 2002 the benefits included a premium for long-term disability coverage which is now integrated in PSP Investments Group Insurance coverage. In addition to the above, the executive officers are covered by a contributory defined benefit pension plan which provides them with a pension benefit of 2% of the best 3 years average earnings for each year of service.

**9. ALLOCATION OF NET INCOME (LOSS) FROM OPERATIONS**

The allocation of the net income (loss) from operations of PSP Investments to each Plan Account is as follows:

**(a) Investment Income and Gains (Losses)**

The investment income has been allocated according to the number of units of PSP funds held by each Plan Account.

**(b) Expenses**

The *Act* requires that the costs of operation of PSP Investments be charged to the three plans for which it provides investment services. Under section 4(3) of the *Act*, the President of the Treasury Board shall determine to which Plan Account these costs will be charged in consultation with the Minister of National Defence and the Solicitor General of Canada. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each Plan Account, and allocates, on a quarterly basis, operating expenses excluding custodial fees, based upon the asset value of each Plan Account.

Operating expenses excluding custodial fees have been allocated as follows:

	2003	2002
Public Service Pension Plan Account	70.4%	70.6%
Canadian Forces Pension Plan Account	21.9%	21.7%
Royal Canadian Mounted Police Pension Plan Account	7.7%	7.7%

Expenses are paid by PSP Investments by way of an advance from the Public Service Pension Plan Account, which is reimbursed by the other Plan Accounts on a quarterly basis.