WCB-Alberta

Management Discussion and Analysis of Consolidated Financial Statements and Operating Results

For the year ended December 31, 2016

27 Business Overview

28 2016 Financial Performance
   28 Operating Highlights

30 Customer Operations
   30 Premiums
   31 Claims and Claims Management Expenses
   32 Corporate Administration

32 Financial Management
   32 Investments
   33 Claim Benefit Liabilities

35 Funding
   35 Funding Policy
   35 Funded Position

36 Enterprise Risk Management
   36 Oversight
   36 Risk Assessment
   36 Significant Risks

37 Implications of Accounting Policies and Estimates

38 Governance and Compliance

39 Emerging Standards

40 Looking Ahead
Management Discussion and Analysis of 2016 Consolidated Financial Statements and Operating Results

The Management Discussion and Analysis (MD&A) provides management’s perspective on key issues that affect current and future performance of the Workers’ Compensation Board–Alberta (WCB). The MD&A, prepared as of April 25, 2017, should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2016.

Forward-looking statements
This report contains forward-looking statements about certain matters that are by their nature subject to many risks and uncertainties, which may cause actual results to differ materially from the statements made herein. Forward-looking statements include, but are not limited to, WCB objectives, strategies, targeted and expected financial results. They also include the outlook for WCB’s business and for the Alberta and global economies. Risks and uncertainties include, but are not limited to, changing market, industry and general economic factors or conditions; changes in legislation affecting WCB policies and practices; changes in accounting standards; the ability to retain and recruit qualified personnel; and other risks, known or unknown. Some are predictable or within WCB control; many are not. The reader is hereby cautioned not to place undue reliance on these forward-looking statements.

Unless otherwise indicated, all amounts shown are in millions of Canadian dollars.
Business Overview

Corporate profile
Founded in 1918, WCB is a statutory corporation with a legislative mandate under the Workers’ Compensation Act (the Act) to administer the workers’ compensation system for the province of Alberta. While accountable to the Minister of Labour, WCB is independently funded and operated. Through the payment of premiums, over 162,000 employers fund the system, which covers more than 1.8 million workers.

WCB’s mandate
In Canada, workers’ compensation is a no-fault disability system that protects both employers and workers against the economic impact of work-related injuries and occupational diseases. Based on the Meredith Principles, the system covers injured workers for lost employment income and provides health care, rehabilitation and other services required due to a work-related injury, while employers are shielded from litigation. This system brings economic stability to the workplace through collective liability that minimizes the risks and expenses of injury. To achieve these objectives, the Act established the Accident Fund and imposed a statutory obligation on WCB to ensure that it be fully funded.

At the highest and simplest level, WCB is involved in two significant and complementary business activities: customer operations and financial management.

Customer operations provides disability management for workplace injuries. Key business processes include rate setting, assessment and collection of premiums from employers, payment of compensation benefits to injured workers, return-to-work services and administration.

Financial management involves an integrated risk-based approach within an Asset Liability Management (ALM) framework to manage assets and liabilities so that sufficient assets are available to pay for claim-related obligations. Key business processes within the ALM framework include strategic financial planning, investment management, claim benefit liability analysis and valuation, financial risk management and financial performance reporting. Strong financial management not only ensures security of benefits for workers and fair premiums for employers, but also provides appropriate tools for evaluating how effectively WCB is meeting its financial obligations.

WCB’s vision and mission
The core principles set out in WCB’s vision and mission shape the corporate beliefs and values that guide the organization’s operating philosophy.

Vision
Albertans working—a safe, healthy and strong Alberta.

Mission
WCB-Alberta, working together with our partners, will significantly and measurably reduce the impact of workplace illness and injury on Albertans.

WCB’s strategic vision is to make a positive and lasting impact on the people, society and economy of Alberta through what it does, while the mission statement describes the guidelines for how it intends to conduct business.
2016 Financial Performance

OPERATING HIGHLIGHTS

The funding model for WCB operates on the premise that in a given year, 1) rate setting activities within customer operations will generate premiums to cover all operating costs on a break-even basis, and, 2) Financial Management activities will generate investment returns sufficient to cover the annual interest requirement on the claim benefit liability. Given the volatile performance of local and global economies, forecasting these activities is subject to a great deal of uncertainty and risk. Consequently, actual results will likely differ significantly from even the most rigorously developed plans. Surpluses or deficits can arise when actual costs and returns are different from forecast expectations, which rely on economic and business assumptions based on available information at a point in time. Surpluses and deficits accumulate and are reflected in the funded position.

The factors contributing to surpluses or deficits are better understood when the Consolidated Statement of Comprehensive Income is reorganized to represent WCB’s main business activities, as follows:

**Customer operations – Lower than expected premium revenues resulted in a $64.2 million deficit.**

- A weak Alberta economy in 2016 presented challenges for both injured workers and employers as modified work opportunities declined. The commitment of WCB’s customer operations teams and the shared focus on return to work, modified work and early vocational rehabilitation planning helped to prevent job-loss and economic hardship in a particularly tough economy.
- Employer insurable earnings of $99.8 billion were $9.7 billion (8.9 per cent) below budget, and $6.1 billion (5.8 per cent) lower than 2015. As a result, premium revenue ended the year at $994.5 million, which was $129.9 million (11.6 per cent) below budget and $30.1 million (2.9 per cent) below 2015. This was partially offset by lower claim volumes and a decrease in the overall workforce exposure, which resulted in claims and claims management expenses of $899.7 million being $55.0 million (5.8 per cent) below budget and $12.1 million (1.4 per cent) above 2015. Overall, the premium rate collected was $1.01, compared to a required rate of $1.06.
- Disabling claim and lost-time claim volumes decreased by similar rates at 6.4 per cent, compared to 2015. Disabling claim volume decreased to 45,300 from 48,400 in 2015 and the resulting disabling injury rate per 100 covered workers was 2.4, unchanged from 2015. Lost-time claim volume decreased to 24,800 from 26,500 in 2015.

**Financial management – Investment returns offset actuarial losses resulting in a $38.2 million surplus.**

- Investment earnings were up in 2016, delivering net investment income of $713.8 million, which was $344.6 million (93.3 per cent) above budget, and $78.0 million (12.3 per cent) above 2015. Despite a collapse and subsequent rebound in commodity prices, heightened geo-political tensions, and fluctuating stock market valuations, the portfolio earned a total rate of return of 7.3 per cent, which exceeded the benchmark return of 5.8 percent and the budget return expectation of 4.1 per cent. Canadian equities, infrastructure and fixed income produced notably better than expected results.
- Negative actuarial remeasurement adjustments of $321.6 million were primarily driven by a decrease in the real rate of return assumption used for discounting the expected future benefit payments to present value and from adjustments to benefit payments. The rate decreased from 2.75 per cent to 2.5 per cent per annum.

Overall, the Funded Position ended the year at $2,657.8 million and the funded ratio (total assets over total liabilities) at 133.8 per cent.
The following tables represent the operating highlights for each of our key business activities:

**Operating results by business activity**

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2016 Budget</th>
<th>2016 Actual</th>
<th>2015 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer operations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums</td>
<td>$1,124.4</td>
<td>$994.5</td>
<td>$1,024.6</td>
</tr>
<tr>
<td>Claims and claims management</td>
<td>(954.7)</td>
<td>(899.7)</td>
<td>(887.6)</td>
</tr>
<tr>
<td>Corporate administration and injury reduction</td>
<td>(164.7)</td>
<td>(159.0)</td>
<td>(154.4)</td>
</tr>
<tr>
<td>Surplus (Deficit) from customer operations</td>
<td>5.0</td>
<td>(64.2)</td>
<td>(17.4)</td>
</tr>
<tr>
<td><strong>Financial management</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>409.9</td>
<td>750.8</td>
<td>675.1</td>
</tr>
<tr>
<td>Investment management</td>
<td>(40.7)</td>
<td>(37.0)</td>
<td>(39.3)</td>
</tr>
<tr>
<td>Net investment income</td>
<td>369.2</td>
<td>713.8</td>
<td>635.8</td>
</tr>
<tr>
<td>Interest expense on claim benefit liabilities</td>
<td>(349.7)</td>
<td>(348.9)</td>
<td>(336.3)</td>
</tr>
<tr>
<td>Remeasurement gain (loss) on claim benefit liabilities</td>
<td>-</td>
<td>(321.6)</td>
<td>129.2</td>
</tr>
<tr>
<td>Other expense items</td>
<td>(5.9)</td>
<td>(5.1)</td>
<td>(5.8)</td>
</tr>
<tr>
<td>Financial management expenses</td>
<td>(355.6)</td>
<td>(675.6)</td>
<td>(212.9)</td>
</tr>
<tr>
<td>Surplus from financial management</td>
<td>13.6</td>
<td>38.2</td>
<td>422.9</td>
</tr>
<tr>
<td><strong>OPERATING SURPLUS (DEFICIT)</strong></td>
<td>$18.6</td>
<td>$(26.0)</td>
<td>$405.5</td>
</tr>
</tbody>
</table>

**Sources of operating surplus (deficit)**

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2016 Budget</th>
<th>2016 Actual</th>
<th>2015 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Surplus (Deficit) from customer operations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium revenue shortfall resulting from the actual premium rate collected of $1.01 (2015 – $0.97) being lower than the required premium rate of $1.06 (2015 – $0.98), based on insurable earnings</td>
<td>$ -</td>
<td>$ (55.8)</td>
<td>$(8.5)</td>
</tr>
<tr>
<td>Other revenue (expense) items</td>
<td>5.0</td>
<td>(8.4)</td>
<td>(8.9)</td>
</tr>
<tr>
<td>Surplus from financial management</td>
<td>5.0</td>
<td>(64.2)</td>
<td>(17.4)</td>
</tr>
<tr>
<td><strong>Investments</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net excess of investment revenue over the claim benefit liability interest expense of $348.9 million (2015 – $336.3 million)</td>
<td>19.5</td>
<td>364.9</td>
<td>299.5</td>
</tr>
<tr>
<td>Other expense items</td>
<td>(5.9)</td>
<td>(5.1)</td>
<td>(5.8)</td>
</tr>
<tr>
<td></td>
<td>13.6</td>
<td>359.8</td>
<td>293.7</td>
</tr>
<tr>
<td><strong>Actuarial remeasurement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Changes in actuarial methods and assumptions</td>
<td>-</td>
<td>(168.5)</td>
<td>-</td>
</tr>
<tr>
<td>Changes in policies and procedures</td>
<td>-</td>
<td>(152.7)</td>
<td>-</td>
</tr>
<tr>
<td>Gain (loss) due to claims experience</td>
<td>-</td>
<td>(321.6)</td>
<td>129.2</td>
</tr>
<tr>
<td></td>
<td>13.6</td>
<td>38.2</td>
<td>422.9</td>
</tr>
<tr>
<td><strong>OPERATING SURPLUS (DEFICIT)</strong></td>
<td>$18.6</td>
<td>$(26.0)</td>
<td>$405.5</td>
</tr>
</tbody>
</table>
Customer Operations

PREMIUMS

**Insurable earnings**
- $9.7 billion (8.9 per cent) under budget
- $6.1 billion (5.8 per cent) lower than prior year
The recessionary environment in Alberta led to insurable earnings being below both budget expectations and prior year. Reductions reflected a decline in the total number of hours worked in the province, as well as a reduction in the average hourly wage. Sectors most notably impacted were construction; mining, oil and gas; and manufacturing.

**Premium revenue**
- $129.9 million (11.6 per cent) under budget
- $30.1 million (2.9 per cent) lower than prior year
Weakness in insurable earnings negatively affected premiums. Sectors that primarily contributed to the $129.9 million negative budget variance were construction; mining, oil and gas; and manufacturing.

Premium revenue decreased by 2.9 per cent to $994.5 million in 2016, due in part to a year-over-year decline of 5.8 per cent in employer insurable earnings, partially offset by a 4.1 per cent increase in the average collected premium rate, from $0.97 to $1.01.

**Premium rates and insurable earnings**
The chart below presents insurable earnings vs average premium rate required from 2012 through 2016. The trending decline in the average premium rate required up to 2014 was the result of growth in insurable earnings, which outpaced growth in claims expense. Since 2015, the trend has reversed with the average premium rate required increasing due to insurable earnings declining at a greater pace than the decline in claims expense.
**CLAIMS AND CLAIMS MANAGEMENT EXPENSES**

Claim expenses are an estimate of current and future costs arising from compensable injuries and exposures to occupational diseases occurring in 2016, as well as the future costs to administer these claims.

- $55.0 million (5.8 per cent) lower than budget
- $12.1 million (1.4 per cent) higher than prior year

Claims and claims management expenses were below budget primarily due to lower health care costs resulting from lower claim volume. The increase over 2015 is primarily due to actuarial adjustments.

**Claim volume and claim rates**

Both components of disabling claim volume (claims resulting in lost time from work, and those resulting in no time lost due to a return to modified duties) declined in 2016, although the rate of decline softened from 2015. This decrease resulted from the continued weakness in the Alberta labour market, manifesting in lower levels of employment, and an elevated unemployment rate. While claim volume fell in 2016, the number of covered workers in the province also declined, resulting in no change in the disabling and lost-time claim rates per 100 covered workers.
CORPORATE ADMINISTRATION

$4.1 million (4.3 per cent) under budget
$1.2 million (1.3 per cent) higher than prior year

Corporate administration expenses exclude costs for administering claims (2016 – $105.6 million, 2015 – $101.5 million) that are included in claims management expenses. Corporate administration came in under budget due to operational efficiencies, while year-over-year cost increases are attributable to inflationary impacts.

Financial Management

INVESTMENTS

Net Investment income

$344.6 million (93.3 per cent) over budget
$78.0 million (12.3 per cent) higher than prior year

Net investment income was higher than budget, primarily driven by better than expected returns in Canadian equities, infrastructure and bonds. Overall, the portfolio earned a total rate of return of 7.3 per cent for 2016 (budget was 4.1 per cent) on par with the 7.0 per cent return in 2015. This was also above the long-term actuarial required nominal rate of return.

The portfolio is prudently managed within a robust ALM framework, which involves an integrated risk-based approach to managing the fund’s assets within the context of the claim benefit obligations they are expected to safeguard. ALM helps determine an appropriate investment strategy to reduce funding risk. The Act requires that the Accident Fund remain fully funded such that sufficient assets are maintained to pay for the obligations of the fund (liabilities). It follows that the financial risks inherent in those assets and liabilities need to be fully understood and carefully managed in order to ensure that fluctuations on either side do not cause the Accident Fund to become unfunded.

Financial risks are modeled and studied on a regular basis to confirm that the portfolio can deliver on its requirement to pay for the obligations of the fund well into the future. Volatility in investment markets and the economic environment makes this a complex and challenging exercise. However, strong risk management practices supported by modeling software provide a systematic and consistent platform for monitoring the emerging risk profile of the assets and liabilities. Throughout the year, risk metrics confirmed that the Accident Fund was operating within an acceptable level of risk.

Investment returns played a key role in WCB’s 2016 financial results. The following provides an overview of the economic and market forces that had a direct impact on WCB’s investment portfolio and returns.
**Capital markets overview**

2016 was a year of surprises: oil prices reached a low of $26 per barrel, then rebounded at the end of the year to just over double that level, the U.K. voted to leave the European Union in the historic Brexit referendum and Donald Trump was unexpectedly elected as President of the United States. While these events resulted in significant volatility in financial markets, anxiety quickly eased and most equity and commodity markets ended the year with solid gains. With a return of over 21 per cent, Canadian equities were the leading performer. Fixed income markets performed strongly in the first three quarters of 2016, but experienced a challenging fourth quarter as yields rose sharply on the prospect of faster U.S. economic growth and a potential rise in inflation.

The commercial real estate market performed in line with expectations, but with significant regional variations. British Columbia and Ontario continued to do well, while energy dependent markets experienced negative capital returns. Infrastructure demand from global investors remained robust and the asset class continued to produce strong returns.

**Portfolio performance**

The portfolio earned a total rate of return of 7.3 per cent for 2016 (1.5 per cent above the policy benchmark) and 8.9 per cent for the four-year period ending December 31, 2016 (2.1 per cent above the policy benchmark). These returns are consistent with the expected level of risk set in the Investment Policy and by the ALM framework. The primary goal of the investment portfolio is to earn a rate of return that meets or exceeds the long-term actuarial nominal rate of return (referred to as the actuarial discount rate). On this basis, the portfolio’s rate of return for 2016 of 7.3 per cent was significantly above the long-term actuarial required rate of 4.55 per cent.

**CLAIM BENEFIT LIABILITIES**

At the end of each fiscal year, WCB determines its claim benefit liabilities for all injuries and illnesses that have occurred on or prior to that date, as well as for past exposures that may result in future occupational disease claims. These liabilities represent the actuarial present value of all future benefits and related administration costs, excluding costs attributable to self-insured employers. As at December 31, 2016, those future payments totaled $15,623.9 million and, when discounted using a nominal rate of return assumption of 4.55 per cent per annum, resulted in claim benefit liabilities of $7,553.0 million—an increase of $685.7 million over 2015.

**Effect of discounting**

The difference between the future payments and the present value highlights the significant effect of discounting, as shown in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Years 1 to 5</th>
<th>Years 6 to 15</th>
<th>Years 16 &amp; beyond</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing of future payments</td>
<td>$2,568.2</td>
<td>$3,979.3</td>
<td>$9,076.4</td>
<td>$15,623.9</td>
</tr>
<tr>
<td>Effect of discounting</td>
<td>(244.3)</td>
<td>(1,392.1)</td>
<td>(6,434.5)</td>
<td>(8,070.9)</td>
</tr>
<tr>
<td>Claim benefit liabilities</td>
<td></td>
<td></td>
<td></td>
<td>$7,553.0</td>
</tr>
</tbody>
</table>

Benefit obligations extend well out into the future. Almost 84 per cent of future payments are expected to occur in year 6 and beyond.
Significant changes in liabilities
The overall $685.7 million increase in claim benefit liabilities was attributable to the following:

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>2016 changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Operations related</td>
<td></td>
</tr>
<tr>
<td>Provision for future costs of current-year injuries and exposures</td>
<td>$ 653.7</td>
</tr>
<tr>
<td>Benefit payments for prior years’ injuries</td>
<td>(638.5)</td>
</tr>
<tr>
<td>Financial Management related</td>
<td></td>
</tr>
<tr>
<td>Interest expense on the liability</td>
<td>348.9</td>
</tr>
<tr>
<td>Changes in actuarial methods and assumptions</td>
<td>168.5</td>
</tr>
<tr>
<td>Changes in policies and procedures</td>
<td>152.7</td>
</tr>
<tr>
<td>Claims experience loss</td>
<td>0.4</td>
</tr>
<tr>
<td></td>
<td>$ 670.5</td>
</tr>
</tbody>
</table>

Actuarial methods and assumptions
The following actuarial methods and assumptions changes increased claim benefit liabilities by $168.5 million:

- Updates to economic assumptions, including the decrease in the real rate of return assumption (nominal less inflation) from 2.75 per cent to 2.5 per cent per annum ($219.4 million increase).
- Revised assumptions relating to the valuation of latent occupational disease claims ($88.4 million decrease).
- Changes in the methods and assumptions used for valuing long term health care benefits ($37.5 million increase).

Policies and procedures
The $152.7 million increase in the claim benefit liabilities is for benefit amount increases to personal care allowances and housekeeping allowances effective January 1, 2017.

Claims experience
Differences between actual experience and what was expected in the prior valuation result in experience gains (which decrease the liability) or losses (which increase the liability). The impact of actual 2016 experience resulted in an overall experience loss of $0.4 million. The primary reasons for the loss were that economic loss payments were higher than expected (increased the liability by $118.7 million), as were other benefit categories (increased the liability by $14.1 million) while actual wage growth and inflation were lower than expected (decreased the liability by $132.4 million).

The following chart shows the breakdown of the claim benefit liabilities as at December 31, 2016, by benefit type:
Funding

FUNDING POLICY

The Funding Policy is the primary instrument through which WCB manages its capital or fund structure and provides direction for setting premium rates and optimum funding level. Details of the Funding Policy may be found in the Policy and Legislation section of WCB’s website. Discussion is also included in Note 4 Funding, in the accompanying consolidated financial statements and notes.

Funding principles and objectives

The strategic aim of funding and investment policies is to strive for balance between financial risk (i.e., volatility), investment returns and funding stability. Specifically, the Funding Policy embodies these financial objectives:

- Minimize the risk of becoming unfunded.
- Minimize cost volatility to employers.
- Charge premiums that reflect the cost of current-year injuries.

The funding mechanisms that evolve from these objectives address those risks that may affect the financial stability of WCB—primarily investment volatility. Funding Policy rules are in place to minimize these risks, with ongoing monitoring and evaluation to ensure they continue to respond effectively to changing economic conditions.

FUNDED POSITION

The Funded Ratio (total assets to total liabilities), as at December 31, 2016, is 133.8 per cent, (2015 - 134.3 per cent) which is slightly above the upper end of the funding policy target range. Viewed from another perspective, WCB has total assets of $10.5 billion to cover the present value of its total estimated liabilities of $7.9 billion. Despite the positive funded position, the potential changes in legislation or WCB operations as a result of the legislative review of the workers’ compensation system may impact the Accident Fund. As such, WCB has deferred a decision on payment of a surplus distribution in 2017 until the full impact of the review panel recommendations is quantified.

The chart below presents the Funded Position from 2012 through 2016.
Enterprise Risk Management

OVERSIGHT

Under WCB’s corporate governance structure, the Board of Directors is responsible for overall risk management. The executive team, which has a mandate to identify and manage enterprise-level risk, is assisted by the Planning & Priorities Committee, composed of a group of senior managers with responsibility for risk identification, assessment and mitigation at the operating level.

RISK ASSESSMENT

WCB has three primary processes for managing risk. First, risk management is integral to the day-to-day business. Major projects and changes to business processes must go through a documented risk analysis to assess risk and identify mitigation plans and controls to lessen the likelihood or impact of these risks. The second process is to complete a systematic and comprehensive risk assessment of emerging corporate risks as they develop throughout the year. Finally, WCB also completes an annual corporate risk assessment that engages departmental management teams and senior managers to develop a comprehensive organizational risk register. The executive team prioritizes those risks with the highest potential residual impact to WCB and selects a number for comprehensive risk assessment and mitigation.

SIGNIFICANT RISKS

WCB has identified the following risk exposures that could have significant impact on the organization and its operations.

**Benefit cost risk**

Many of WCB’s claim-related benefits are subject to external factors that have potentially significant impacts on the amount and duration of related benefit costs. These risks and uncertainties are driven largely by economic conditions such as health care inflation and utilization, and wage growth. Other factors may also arise through administrative precedents established through the appeals process, legislative changes or from new medical findings for occupational disease. All of these factors add significant uncertainty to WCB’s cost structure and may impose, over time, pressures on the funding model.

**Fraud-related risk**

Every year, WCB collects approximately one billion dollars in premium revenue and distributes or reserves a similar amount for claim benefits and administrative costs. The magnitude of these costs and the number of individuals and companies involved in these processes—over 162,000 employers, 164,000 injured workers and thousands of service providers—creates inherent risk for fraud. WCB employs an extensive audit program to monitor the organization’s ability to protect against fraud and implements additional controls, as required, to strengthen WCB’s management of fraud risk.

**Funding risk**

Managing the components of WCB’s overall Funded Position is a complex process that involves forecasting, liability projection, investment management and operational performance. Although processes are within management’s influence or control, many of the assumptions used in forecasting involve significant uncertainty regarding the future. Asset-liability management continues to be enhanced to provide better systems, tools, processes and information to enhance forecasting, financial planning and decision-making processes within WCB.

**Investment risk**

In its investment portfolio, WCB is exposed to financial risk, which includes market and portfolio risk, among others. Market risk is the risk that the fair value of investments and/or associated cash flows may change because of changing general economic conditions or events that broadly affect capital markets. Portfolio risk relates to specific composition and management of WCB’s portfolio. Details of financial risks related to investments are discussed in Note 6 Investment Risk Management, in the accompanying consolidated financial statements and notes.
Premium risk
WCB has exposure to premium risk, which is the risk that premiums set for the coming fiscal period will not be sufficient to cover the operating costs in that year. This risk is largely driven by provincial economic conditions such as employment growth and wage escalation. To manage premium risk, WCB has instituted a comprehensive forecasting program that leverages widely accepted economic-forecasting sources such as the Conference Board of Canada.

Technology risk
To support its core business processes, WCB uses a number of information systems for processing transactions and maintaining injured worker and employer information. If these systems were to fail or were compromised, significant disruption to business processes and customer service could result. To mitigate technology risk, WCB maintains a business continuity plan, system controls and backup systems to address processing failures and provides extensive training to develop internal system expertise.

Implications of Accounting Policies and Estimates

Preparation of consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) requires management to make judgements, assumptions, and estimates that could materially affect the results of operations and financial condition of WCB. The following discusses those significant accounting policies that entail significant use of judgement and estimates. For further discussion of accounting impacts, please refer to the accompanying consolidated financial statements and notes.

Investments
WCB must apply judgement to determine whether it has control or significant influence with respect to the activities of its investees, which will affect whether the consolidation of an investee is required. Additional details are found in Note 5 Investments, in the section Interests in unconsolidated structured entities.

WCB’s investment assets are financial instruments measured at fair value at each reporting date. Fair value measurement, which reflects realizable market value, could lead to significant volatility in the statement of financial position during periods of economic and market instability. For those investments whose fair value is not based on observable market inputs, judgement must be applied in selecting and/or developing appropriate valuation techniques, assumptions, and data.

The fair value of a derivative contract is its change in value with respect to the change in the underlying security or reference index to which the contract is linked. In addition, the fair value of derivative contracts must reflect potential counterparty default risk, which is mitigated by transacting only with those counterparties whose credit risk is insignificant. Because such fair value changes are recognized in income in the periods in which they arise, investment income for those periods may be volatile. When the closing positions of derivative contracts represent material gains and losses, their settlement may result in large unanticipated cash inflows and/or outflows.

Details of the investment assets and their inherent risks are in Note 5 Investments and Note 6 Investment Risk Management in the accompanying consolidated financial statements and notes.

Valuation of employee benefit liabilities
WCB has applied defined benefit accounting for employee post-employment plans, which requires an actuarial determination of benefit obligations extending well into the future for post-employment benefits to employees. The actuarial process projects benefit cost streams into the future and discounts them to present value using a discount rate linked to market yields on high quality corporate bonds with similar characteristics as the liabilities. Measurement uncertainty is high because assumptions regarding the amount, timing, and duration of future benefit commitments are inherently difficult to predict reliably, and are factors outside management’s control.

Details of WCB’s multi-employer and sponsored defined benefit plans are in Note 10 Employee Benefits in the accompanying consolidated financial statements and notes.
Valuation of claim benefit liabilities
WCB has significant obligations for benefits to injured workers extending well into the future. In order to estimate these future obligations, WCB applies the actuarial present-value methodology for its claim benefit liabilities. The actuarial process projects benefit payment streams into the future and discounts them to present value using a discount rate linked to the return on investment assets funding those liabilities. Measurement uncertainty is high because the assumptions regarding the amount, timing and duration of the benefit commitments and future return on assets are difficult to forecast, and are influenced by external factors that are inherently unpredictable. Consequently, the selection of one assumption over another in estimating claim benefit liabilities could have a material impact on the liability valuation.
Details of the valuation, along with sensitivity of the associated risks are in Note 11 Claim Benefit Liabilities and Note 12 Claim Benefit Risks in the accompanying consolidated financial statements and notes.

Premiums
The reported premium revenue at year-end includes an estimate of premium adjustments, as well as an estimate for safety rebates earned by participating employers that have met performance criteria for workplace safety. Generation of these estimates requires significant use of judgement in developing the methodology as well as the relevant economic assumptions. As such, actual premiums and safety rebates may differ significantly in periods of economic uncertainty.
Details of these estimates are in Note 13 Premium Revenue in the accompanying consolidated financial statements and notes.

Governance and Compliance

Legislative authority
Under the authority of the Act, WCB is a provincial board-governed organization that operates independently while reporting to the Minister of Labour.

Internal control over financial reporting
Management is responsible for establishing and maintaining adequate internal control over financial reporting (ICOFR) to provide reasonable assurance regarding the reliability of the entity’s financial reporting and the preparation of its consolidated financial statements in accordance with IFRS. WCB has developed a framework and plan for the overall ICOFR program. The framework is based on best practices under the COSO1 and COBIT2 frameworks. The ICOFR program is assisted by WCB’s Management Audit Services group and program results are shared with the Office of the Auditor General.

Business planning
An important aspect of financial planning and budgeting is linkage to WCB’s strategic plan and the resulting corporate objectives developed each year in support of the strategic plan. These objectives and the related performance indicators set the direction for the organization and identify the significant areas of focus for the coming year. The annual budget establishes the foundation for appropriate resource allocation for achieving the corporate objectives.

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1 Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013 Framework), which developed a governance framework for internal control.

2 Control Objectives for Information and Related Technology, a collection of best practices for IT governance, control and assurance.
Emerging Standards

WCB conducts continuous environmental scanning of the financial reporting and actuarial standard-setting landscape for important developments in recognition and measurement of critical financial statement items that may have significant implications for funded position and financial performance in the current and future reporting periods. Once the revised standards are officially issued, WCB analyzes their key requirements to ensure that major impacts are well understood, such that timely planning and effective implementation of accounting processes and systems will result in high-quality financial reporting.

The following are the major developments in professional standards that WCB is closely monitoring:

Financial instruments
The IASB released the final version of IFRS 9 in July 2014 with a mandatory effective date of January 1, 2018. As WCB had already adopted phase one (classification and measurement) in 2011, its assessment of the standard focused on phase two (impairment) and phase three (hedge accounting). WCB has concluded that phase two is not expected to have a material effect on financial position or results of operations, and phase three will not be applicable to WCB’s hedging activities. For further discussion of how IFRS 9 will be applied, see the section in Note 3 Accounting Policy Changes for standards issued but not yet effective, in the accompanying consolidated financial statements and notes.

Revenue from contracts with customers
IFRS 15, issued May 2014, introduces a new revenue recognition framework. The core principle of IFRS 15 is that revenue is recognized when promised goods or services to customers are transferred to customers in an amount that reflects the consideration expected to be exchanged for those goods or services. For WCB, IFRS 15 will entail only presentation and disclosure changes, and is not expected to have a material impact as WCB’s major revenue streams fall outside its scope – that is, within the scope of IFRS 4 Insurance Contracts (premium revenue) and IFRS 9 Financial Instruments (investment income).

IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted.

Leases
IFRS 16, issued January 2016, will require the lessee to recognize all leases (both finance and operating) in the statement of financial position as assets and corresponding liabilities, with limited exceptions. The guidance remains largely unchanged for finance leases, but recognition of operating leases could materially increase both assets and liabilities. For such leases, adoption of IFRS 16 will require recognition of a right-of-use asset measured at the present value of future lease obligations, which will be amortized over the expected lease term in accordance with the depreciation requirements of IAS 16 Property, Plant and Equipment.

IFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019, with early adoption permitted. An implementation plan is expected to be developed in 2017.

Insurance contracts
Now in the final stage of drafting, IFRS 17 is targeted for release in May 2017. It will replace IFRS 4 in its entirety. Expected impacts will be significant for WCB and are expected to affect actuarial processes, data requirements, systems retooling, and valuation methodologies. Additionally, recommendations will introduce important new concepts, definitions, recognition, and measurement approaches for insurance liabilities and revenue, which will drive related major revisions in financial statement presentation.

Most significant for WCB is how the rate used to discount future cash flows arising from its claim liabilities will be established. The prescribed approach will likely require development of a yield curve using observable market data for the actual or a reference portfolio of assets with similar characteristics as the liabilities. The change in discount rate methodology could introduce potentially material increases or decreases in claim benefit liabilities, as well as their volatility in subsequent periods experiencing interest rate instability. The funding policy will need to be reviewed as part of the implementation.

The IFRS 17 effective date is expected to be no later than January 1, 2021, with early adoption likely to be permitted. A multi-year implementation plan is expected to be developed in 2017, and will be based on the final standard as released.
Looking Ahead

Looking forward to 2017, WCB will continue to manage its business in light of global and provincial economic uncertainty. WCB’s business priorities are to build on operational and financial strategies that have contributed to its organizational success. Management will closely monitor economic and operating trends to develop proactive and measured responses to emerging business issues.

Economic and capital market outlook

The economic and capital market outlook continues to be laden with uncertainty heading into 2017. For the global economy, U.S. growth could get a boost if the new government, as promised, implements stimulative fiscal policies. However, many other regions, including Canada, are still mired in sluggish growth, albeit improving.

The newly elected U.S. President is also stoking fears of trade protectionism that could spark a global trade war. The outlook for global growth thus depends in part on the extent to which the U.S. administration will embrace protectionism. Further movement in that direction would heighten risks to the sustainability of global growth. For Canada, the spectre of rising U.S. protectionism may temporarily weigh on business investment, though stronger U.S. growth could spur exports, but only if the U.S. administration does not implement a proposed 10 per cent border adjustment tax.

Turning again to Alberta, expectations for incremental improvements in oil prices lead to a baseline expectation of a modest recovery for the Alberta economy. Reconstruction efforts in the wake of the Fort McMurray forest fire should provide a further stimulative boost. A significant departure from business as usual, recently seen in energy markets, warrants more caution than usual in terms of adopting baseline forecasts. This uncertainty also weighs on the decision-making process of oil producers, making them less likely to commit to the massive up front capital expenditures and long production horizons of the Alberta oil sands projects that fueled the most recent boom.

Markets have so far responded with optimism and momentum and associated improvements in the earnings outlook is expected to support equities into early 2017. However, it appears that expectations are not discounting the uncertainty surrounding the implementation of the President’s vision. They are also ignoring for now the consequences for the U.S. dollar, government deficits, interest rates, trade and inflation. Interest rates and the U.S. dollar have already moved higher and continuation of that trend could offset any potential positives from expected fiscal stimulus.

While economic conditions seem generally better than a year ago, the world is still suffering from a low economic speed limit and downside risks remain. In an environment where the economic cycle is mature, equity valuations are elevated and the risk of political missteps are high, equity market returns are expected to be modest.

The outlook for interest rates depends on the extent to which reflation efforts take hold. Currently, only the U.S. Federal Reserve is expected to raise interest rates in 2017 with the Bank of Canada and the European Central Bank keeping official policy rates unchanged. The return from fixed income is therefore expected to be low or even negative if reflationary trends accelerate and yield curves continue to steepen.

Given the economic backdrop, WCB’s total portfolio return for 2017 is budgeted at 4.1 per cent. However, continued market volatility suggests that the actual returns for 2017 may be significantly different from this planning assumption.

Forecasting short-term market performance is extremely difficult. Studies show that investors can detract from returns when trying to time short-term capital market movements. WCB is a long-term investor with a strong financial position. This allows for patience and the ability to stay committed to proven investment principles and beliefs.
**Business outlook**

**Customer operations**
WCB cares about helping injured workers and employers achieve positive results following a workplace incident causing injury or illness. By making fair decisions, WCB employees ensure clients receive the right benefits and services to help them recover their health and independence.

A safe return to work is a partnership; it is the strength of our relationships with employers, injured workers and health care providers that creates an environment where workers are well supported in their recovery and return to work.

In 2017, WCB is expected to receive recommendations from the government-appointed Workers’ Compensation Board Review Panel. While the impact of any recommendations related to legislation, policies or processes are indeterminable at this time, WCB is committed to maintaining high-quality standards to ensure clients receive the best care from all participants in the workers’ compensation system. Together, we will minimize the impact of work-related injury and illness.

**Financial management**
Financial management is based on an investment policy derived from asset-liability studies that consider the year-by-year liabilities of the fund together with the probabilities of associated investment returns. This results in an allocation to stocks, bonds and other assets that changes moderately from year to year and generally performs well, notwithstanding some volatility from year to year.

The Investment Policy includes inflation-sensitive assets, which help to lower volatility while providing a level of return that contributes to the continued financial strength of the fund.

**2017 premium rate**
For 2017, the average premium rate is budgeted at $1.02 per $100.00 of insurable earnings. Insurable earnings are budgeted to grow by 4.6 per cent to $104.4 billion, representing a tempered outlook in light of weak economic growth and depressed commodity prices. Lost-time claim volume in 2017 is expected to remain stable to 2016, while fully-funded costs (i.e., the full cost of injuries that take place in the rate setting year, which includes a provision for the future costs that are expected to be incurred for those injuries) are expected to grow in proportion to insurable earnings due to pressures on health care and rehabilitation benefits as additional efforts are focused on return-to-work outcomes. Any change in the mix of actual growth between insurable earnings and fully funded costs will have an impact on the average premium rate that is ultimately required.

**Outlook for financial condition**
At the end of 2016, WCB’s funded ratio was 133.8 per cent (assets over liabilities). Given economic uncertainty and the volatility of investment returns, it is difficult to determine, with any certainty, WCB’s funding position into the future. Despite these uncertainties, WCB’s broad based risk management framework is designed to mitigate, where possible, this economic and capital market volatility. The outlook for 2017 is based on an expectation that the commodity downturn of the past two years is over and that a recovery is under way. With that said, the pace of the recovery is expected to be quite gradual. A return to modest economic growth should boost wages and employment, lifting insurable earnings and therefore premium revenues. On the cost side, the same uptick in activity will place upward pressure on claim volume and associated costs. The relative magnitude of these changes is uncertain and will affect the size of the resulting operating surplus or deficit.
Facing the future

2017 will continue to present challenges and our partnerships will be more important than ever. Collaboration and communication are the keys to ensuring continued success for system stakeholders. Our collective focus will be to ensure:

- Employers continue to enhance performance and accountability;
- Workers feel engaged and achieve a sense of ownership in the return-to-work process; and
- WCB employees maintain their strong commitment to efficient and proactive case planning.

Working together we will continue to deliver a compensation system that fairly balances the interests of workers and employers and achieves positive return-to-work results.