

## 1.0 Executive Summary

A review of the Workers Compensation Board of Manitoba (WCB) was undertaken by the Office of the Auditor General (OAG) in response to a number of concerns which were brought to our attention, regarding issues of: Board Governance; Human Resources; and Investment Management.

On September 30, 2004, letters were provided to the former Chair of the WCB and to the Minister charged with the administration of The Workers Compensation Act confirming that the OAG planned to review these concerns.

The review was conducted from October 2004 through November 2005. Numerous interviews were conducted and extensive documentation was reviewed. We reviewed information primarily for the period from January 1, 1999 to June 30, 2004. In some instances, our review was extended to December 31, 2004. Our review included such tests and other procedures that we determined were necessary to address the concerns raised, and to address the issues that arose during the course of our work.

We contracted with a firm knowledgeable of, and with experience in, human resources and respectful workplace issues to review the human resource concerns and conduct a review of human resource practices at WCB.

We also contracted with an individual knowledgeable of investment management practices to conduct a review of WCB's private placement investment process and policy and WCB's local real estate investment process and policy.

It is important to note that the WCB is in a good financial position and has maintained an overall surplus for a number of years, which at December 31, 2004 was \$70.5 million. However, it should also be noted that even a financially sound organization can experience governance and management issues.

### MAIN MESSAGES

In 2001, the former Chief Executive Officer (CEO) of the WCB brought forward a number of concerns to the former Minister charged with the administration of The Workers Compensation Act (Minister) and to WCB's Board of Directors (the Board). In our opinion, the need for our review may have been precluded by the former Minister and the Board having dealt with the concerns in an open and transparent manner, including arranging for a formal, independent review at that time. We found that some of the concerns raised by the former CEO did result in operational changes at the WCB. However, based on our review, several of the other concerns which had merit were not remedied.

We have highlighted **five main messages** that arose from our work:

#### 1. Public Sector Entities Have a Responsibility to Be Open and Transparent

We are disappointed that one of our messages arises from the significant, initial difficulties we experienced in obtaining unrestricted access to the information we

required to perform our work. This is the first time that a public sector organization disputed our right of full and uninhibited access to information.

During our review, we encountered several instances of acts and omissions of the WCB and its senior representatives which unduly restricted our work. One particular incident warrants mentioning in this report:

- On January 20, 2005, the former Chair of the WCB telephoned a consultant engaged by the OAG to assist with the review, at her home during the evening. Inappropriate remarks were made to the consultant, and the consultant was left with the clear impression that her career and reputation were in jeopardy if the report produced for the OAG were to be unfavourable to WCB or its former Chair.
- The OAG verbally communicated this incident to the Deputy Minister of Labour and Immigration on January 21, 2005.
- On January 24, 2005, the OAG received a letter dated January 22, 2005 from the former Chair of the WCB offering a full apology to the consultant, and an assurance that events such as described above would not recur. This letter also indicated his personal assurance of full and professional cooperation with the OAG.
- The OAG documented this incident in a letter to the responsible Minister dated February 3, 2005.

The OAG considers this incident involving our consultant to be unacceptable and constituted interference with our review.

Throughout the initial stages of our work there was a strong reluctance on the part of some WCB officials to provide original records and supporting documentation until that documentation was reviewed by WCB senior representatives. Further, several of the persons interviewed were in significant distress and indicated significant apprehension about their careers and/or reputations if WCB were able to link any of our findings to them as individuals or even if WCB senior representatives were aware of the fact that they had been interviewed.

Throughout this review, actions of WCB senior representatives magnified perceptions that there were serious issues in the organization, giving the unfortunate perception that matters were even more serious than those we are including in this report. These actions, in the end, served no constructive purpose that we are able to determine. We found it shocking and unacceptable that a public sector entity constantly questioned our need for, and solicitation of, information necessary to carry out our legislated mandate.

In our opinion, certain of WCB senior executives did not display, nor fully demonstrate, openness and transparency throughout the conduct of our work. As a major public sector organization, we believe that this behavior was inappropriate.

## 2. Serious Concerns Raised in the Public Sector Should Be Fully and Appropriately Addressed

The concerns brought forward to the former Minister by WCB's former CEO related to the operations of the Board and the former Chair. The issues were not addressed by the former Minister, but instead were referred to the former Chair to handle in conjunction with the Board. The former Minister considered this to be a personnel matter. In our opinion, this was inappropriate as several of the concerns raised dealt specifically with the former Chair.

We are also aware of one other instance in which a former CEO's letter of complaint to a Minister received insufficient action on the part of the Minister.

The relationship of an agency like the WCB with government is complex. The Board of Directors is the centre of governance for the WCB, and as such, is responsible for WCB's strategic direction and is accountable for WCB's actions. The Board oversees the management of the WCB and holds management responsible for its performance. The Minister is responsible for the broad policies governing the WCB.

When serious concerns are raised to a Minister with respect to the governance practices of a public sector Board of Directors, we believe that a Minister has a role in ensuring that the issues are appropriately addressed. Having said this, in Manitoba, there is little guidance available to Ministers and Chairs of public sector Boards of Directors to assist them in determining an appropriate response when situations such as this arise. In our opinion, further contemplation is needed about how to handle similar situations that may arise in the future, and whether guidelines are needed to assist Ministers in addressing governance concerns of public sector organizations for which they are responsible.

### **Whistleblowing**

The thrust behind whistleblowing legislation is the concept that it should protect employees of an organization from retaliation for reporting, in good faith, alleged wrongdoings of an organization, the organization's Board, or an organization's employees. Retaliation could include such things as workplace harassment, demotion, termination or any other measure that adversely affects working conditions. Legislation could also provide the whistleblower with direction as to how, and to whom, to raise concerns, and the person or Office that will investigate the concerns raised so that the whistleblower will clearly understand where to direct the concerns. One Canadian Province has enacted this protection through its Civil Service Act however we understand that it does not presently apply to arms-length agencies. The person or Office receiving the complaint would be required to take action and respond within a legislated time period.

Based on our review, some of the concerns raised by WCB's former CEO did result in operational changes and several of the other concerns were found to have merit. It is our opinion that if whistleblowing legislation was in effect in the Province of Manitoba, WCB's former CEO would have had an avenue to address these concerns, as well as assurance that the concerns would be investigated.

### **3. Human Resource Practices Should Include a Focus on Ensuring Respectful Workplaces in the Public Sector**

#### *Respectful Workplace Concerns*

All employees of an organization are entitled to perform their duties within a respectful workplace. Therefore, it is critical that everyone, regardless of their role or position in an organization, conduct themselves in a respectful manner in the workplace. Organizations can benefit from having appropriate, respectful workplace policies and procedures in place to ensure staff are knowledgeable about acceptable practices and that there is a process in place to address concerns.

While any degree of harassment is not acceptable, people in positions of power have an added duty to model respectful behaviour, and to maintain a respectful and harassment free environment within the workplace.

Based on the review of human resource practices conducted, we found that for a number of staff at the senior management ranks, WCB was a hostile work environment, which was never formally acted upon under WCB's harassment protocol or code of conduct policies.

### **4. Board Governance Requires Modernization and Continual Renewal**

#### *Former Chair Involvement in WCB Day-to-Day Operations*

The former Chair had an excessive role in WCB's operational and management activities, therefore blurring the line between governance and management. This is a significant governance concern. A Board has to guard against getting involved in the day to day activities of its organization, which is the responsibility of management. Governance literature is increasingly recognizing the need to separate the position of Chair from that of CEO, due to the inherent conflict.

The total per diem compensation paid to the former Chair, being significantly above the amount paid for Board and Committee meetings held, clearly indicates a substantial level of day-to-day involvement in operations. We were told that the former Chair, who served as both Chair and CEO from May 1995 to October 1998, was unable to relinquish control of the day to day activities of WCB when a new, full-time CEO was hired in October 1998. Interviewees believed this led to a power struggle between the former Chair and the former CEO. Eventually, the former CEO was terminated by the Board and a number of changes to senior management positions followed. Many interviewees told us the former Chair was perceived as the "real boss" and described the former Chair as an authoritarian leader who ran the organization with "iron control".

#### *Board Structure and Operations Should be Reviewed and Updated*

In our opinion, the WCB's Board needs to modernize its governance practices, to ensure that the principles of good governance are fulfilled. The Board's Committee structure should be reviewed to ensure that all Committees are fulfilling an appropriate governance and oversight role, rather than an operational role. The Act establishes the Investment Committee. However, the Act is not specific as to the accountability of the Investment Committee to the Board. In practice, the Investment Committee was not accountable to and did not formally report to the Board. This is a significant governance concern.

The Board operated with a strong emphasis on having unanimous approval. While achieving consensus is a worthy goal, insistence on unanimous decisions could potentially create an environment where independent opinion is silenced. A Board of Directors, by definition, brings together disparate viewpoints and will, on occasion, even after thorough discussion of issues, find that viewpoints may not align, resulting in a vote. It is certainly not inappropriate for a Board member to vote against a motion, nor to have their negative vote recorded. This should not be perceived as taking away from the effectiveness or appropriate functioning of a Board.

#### ***Board Appointment Process Should be Transparent***

Numerous concerns were raised with the appointment process for selecting members to the WCB Board, indicating that a review is needed. In our opinion, requiring each stakeholder group to provide the Minister with a slate of names from which to select qualified candidates and providing a matrix of competencies for the WCB Board to assist the Minister and stakeholders in the consultation process would help ensure that the appointments to the WCB are handled in a more open and transparent manner.

Instituting term limits for Board members and Chair is a way of ensuring continual renewal and fresh perspectives are brought to a Board. Establishing staggered terms with a limited number of reappointments, would balance the Board's need for continuity and experience with the benefits of renewal.

## **5. Private Placement and Real Estate Investing - The Importance of Best Practices and Avoiding the Perception of Conflict of Interest**

### ***The Importance of Implementing Best Practices***

WCB did not use best investment management practices to improve its private placement and real estate investment programs. Absent the use of best practices, it is a testament to the hard work and abilities of Investment Department staff and the Real Estate Consultant that vague objectives, a lack of guidelines, and other obstacles were overcome.

Best investment management practices increase the probability of making quality investment decisions which lead to superior return on investment. They also decrease the risk of loss, including the loss of opportunity due to investing capital in assets that have inferior potential. They are needed in order to "generate the highest possible return", which is one of the stated objectives of the WCB Statement of Investment Policies and Objectives (SIPO document). This objective is consistent with private placements investing given the high long-term return potential promised by institutional investing in Canada's top performing funds.

Our review found that the WCB did not employ best practices in the areas of:

- **Investment Strategy:** WCB did not have a written comprehensive investment strategy for its private placements and Winnipeg-based real estate investment programs.
- **Governance:** In practice, the Investment Committee was not accountable to and did not formally report to the Board of Directors. There was limited private placement and real estate investment expertise on the Committee.

- **Staffing Adequacy:** Investment Department staff learned much of what they knew about institutional private placement investing on-the-job. Professional development opportunities were not formally planned.
- **Leadership:** The former Chief Investment Officer (CIO) did not have a background in private placements, and accordingly, was not in a position to mentor Investment Department staff. A manual on investment processes and procedures was not developed.
- **Due Diligence:** The Investment Department did not perform due diligence on private placement investment opportunities in accordance with industry standards. There was no due diligence guideline, nor checklist available to use as an aid. One basic due diligence matter, confirming the investment track records of the principals of the funds seeking capital from WCB, was not routinely performed.
- **Investment Approvals:** The Investment Committee did not request, and the Investment Department did not document and provide, all of the information reasonably available and necessary to support investment decisions, including approvals.
- **Investment Management, Monitoring and Internal Reporting:** The Investment Committee did not request, and the Investment Department did not document and provide, all of the information available and necessary to regularly assess the progress, status and performance of private placements individually and as a group. Return on investment calculations for each private placement only began as a routine in 2003, and the performance of the entire portfolio over the long-term is not known in terms of either dollars or internal rate of return. A full assessment of the institutional private placement and real estate investment programs present status and strategic direction has not been completed.

### ***Conflicts of Interest***

A conflict of interest is “a situation in which someone in a position of trust, such as a lawyer, a politician, or an executive or director of a corporation, has competing professional and/or personal interests. Such competing interests can make it difficult to fulfill his or her duties fairly. Even if there is no evidence of improper actions, a conflict of interest can create an appearance of impropriety that can undermine confidence in the ability of that person to act properly”.<sup>1</sup>

Conflicts can arise in many different contexts, can be complicated since conflicted relationships are often positioned to provide benefits to the organization through shared costs and expertise, can be difficult to resolve, and as recent corporate scandals have demonstrated, are often overlooked or not fully appreciated.

<sup>1</sup> [http://en.wikipedia.org/wiki/Conflict\\_of\\_interest](http://en.wikipedia.org/wiki/Conflict_of_interest)

The risks associated with conflicts of interest include:

- Inappropriately favouring, or appearing to favour, certain individuals or organizations at the expense of an organization's best interests;
- Diminished flow of quality business opportunities preventing the achievement of performance objectives such as generating the highest possible return on investment;
- Loss of reputation for the organization, its directors, officers and employees; and
- Employee concerns.

Our review of a particular transaction, ABC Fund, provides an illustration of why conflict of interest situations, both in appearance, and in fact, should be avoided.

Guidelines with regard to conflicts of interest were contained in WCB's SIPO document and in the Real Estate Consultant's Portfolio Management Agreement. Ultimately, these guidelines and how they were administered were inadequate, cannot be considered as best practices, and require improvement.

## 2.0 Summary of Main Conclusions

The following table provides a synopsis of the areas examined in this review and the main conclusions. Additional conclusions are contained within the body of the report. All recommendations are contained in **Section 8.0**.

Objective	Report Section	Conclusions
To review the board governance practices of the WCB Board of Directors, including the Committee roles and responsibilities, and the frequency of Board and Committee meetings.	<b>Board Governance</b> <i>Section 5.1</i>	<ul style="list-style-type: none"> <li>In our opinion, the WCB's Board needs to modernize its governance practices to ensure that the principles of good governance are fulfilled. The Board's Committee structure requires review to ensure that all its Committees are fulfilling an appropriate governance and oversight role, rather than an operational role.</li> <li>A significant governance issue for the WCB was the over-involvement of the former Chair in the day-to-day operational and management activities of the organization.</li> <li>The numerous concerns raised with the appointment process for selecting members to the WCB Board indicate that a review is needed. In our opinion, requiring each stakeholder group to provide the Minister with a slate of names from which to select qualified candidates and providing a matrix of competencies for the WCB Board to assist the Minister and stakeholders in the consultation process would help ensure that the appointments to the WCB are handled in a more open and transparent manner. The establishment of staggered terms, with a limited number of reappointments, is a reasonable approach to balancing the Board's need for continuity with the benefits of renewal.</li> <li>WCB's Investment Committee operated with no clear accountability which is a significant governance concern. An Investment Committee must be accountable to the Board of Directors, as it is inappropriate for a Board not to be involved in, nor have oversight of, such a large part of the organization's financial activities.</li> </ul>
To review Board of Director per diems and expenses.	<b>Board Per Diems, Expenses and Other Compensation</b> <i>Section 5.2</i>	<ul style="list-style-type: none"> <li>In our opinion, the former Chair's per diem and expense claims had not been subject to an appropriate approval process.</li> <li>Due to the lack of adequate documentation to support the former Chair's monthly per diem claims, we were unable to verify that the per diem amounts paid to the former Chair were appropriate, or inappropriate, in all instances. The extent of the former Chair's total per diem compensation, for time in excess of meeting time implies a high level of involvement by the former Chair</li> </ul>



Objective	Report Section	Conclusions
		<p>in the day-to-day operational and management activities of the WCB.</p> <ul style="list-style-type: none"> <li>• Per diem and expense payments to other Board members are accurate, properly supported and approved, in most instances.</li> <li>• In our opinion, it was not appropriate for WCB to enter into an agreement with the former Chair providing that the additional compensation, while he served as both Chair and CEO, continued after he ceased to serve as the CEO.</li> <li>• The compensation to the former Chair of WCB was significantly higher than all but one other government enterprise in Manitoba.</li> </ul>
<p>To review concerns regarding inappropriate human resource practices and conduct an organizational review of human resource practices related to senior management positions at WCB.</p>	<p><b>Human Resource Practices</b> <i>Section 6.0</i></p>	<ul style="list-style-type: none"> <li>• As a result of the Human Resource Consultant’s report, we believe that actions are required to enhance WCB’s corporate climate and that a planned process needs to be undertaken to ensure that they have a respectful work environment that fosters trust, fairness, and open communication and open exchange of ideas.</li> <li>• By not having a comprehensive Human Resource Policy and Procedures Manual in place to ensure that all staff members and the Board of Directors are knowledgeable about respectful workplace practices and behavior, and by not having guidance for managers on maintaining a harassment free environment, WCB accepted the risk that disrespectful workplace practices and behavior could occur. Human Resource policies are crucial to the health of an organization as they clarify expectations for Board members, managers and staff.</li> </ul>
<p>To review private placement investment and Winnipeg-based real estate investment transactions, as well as investment consultant expenses.</p>	<p><b>Investment Management</b> <i>Section 7.0</i></p>	<p>We found that private placement investments were generally being managed by the Investment Department in accordance with their Statement of Investment Policies and Objectives (SIPO) document in effect at the time. However, we identified several areas for improvement:</p> <ul style="list-style-type: none"> <li>• The existence of a SIPO document demonstrated the effort of WCB to codify certain elements of what it was trying to do with its Manitoba-based private placement and real estate investments. However, there exist opportunities for improvement in the areas of clarifying rate of return expectations, conflict of interest, and investment criteria for direct private placements that will assist in managing risks associated with these types of investments.</li> <li>• Since the private placements investment strategy was not documented, the risk existed that WCB’s specific</li> </ul>

Objective	Report Section	Conclusions
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and general investment objectives in SIPO would not be achieved. It is difficult to execute, or assess success of, an investment strategy that is not documented.

- Due to the undocumented and largely informal investment processes and procedures that guided the Investment Department, accurate, timely and complete information regarding private placement investments was not reported to the Investment Committee, increasing the risk that poor investment decisions would be made.
- Opportunities to improve WCB’s private placement investment performance may have been sacrificed by continuing to only invest in funds that made investments in Manitoba. This practice may have conflicted with the Committee’s responsibility to “generate the highest possible return” with WCB’s assets.
- In our opinion, the information provided to the Investment Committee as a basis for investment approval was insufficient to determine whether or not an investment opportunity should be approved or declined. Accordingly, the risk of loss on any given investment was increased.
- The Investment Committee did not meet “at least quarterly” to review the progress and status of private placement investments in accordance with their responsibilities as set forth in the SIPO document. Once an investment was booked, and unless there was a formal need to bring an investment before the Investment Committee again, such as the opportunity to invest more of WCB’s funds, internal reporting by the Investment Department to the Investment Committee was largely on an exception and/or request basis only.
- The \$2.0 million deemed carrying value of one private placement investment was not supported by a conventional valuation based on the operating performance of the investment, and therefore is uncertain.
- The institutional private placement investment business is very complex, dynamic and requires knowledgeable people with significant governance and investment experience in order to be effective in an oversight and guidance role. In our opinion, more expertise is needed on the Investment Committee in order to properly oversee WCB’s private placement investment program.
- The Investment Department appropriately managed its relationship with the R/E Consultant. The R/E Consultant’s Agreement, including Schedules, was comprehensive, complete and reasonable in the circumstances.

Objective	Report Section	Conclusions
<p>To review conflict of interest with respect to investment activities of the WCB.</p>	<p><b>Investment Management</b> <i>Section 7.0</i></p>	<ul style="list-style-type: none"> <li>• The R/E Consultant was well-qualified to perform the duties set forth in his Agreement, and generally abided by the Agreement with the exception of the preparation of quarterly and closing reports.</li> <li>• The compensation and expenses of the R/E Consultant were properly supported and approved.</li> <li>• The three Winnipeg-based real estate investments were being managed appropriately, including regarding the maintenance of files, in accordance with R/E Consultant’s Agreement.</li> <li>• The ABC Fund investment illustrates why conflict of interest situations, either in appearance, or in fact, should be avoided. Conflicting roles and concurrent relationships that made the ABC Fund investment problematic from a conflict of interest perspective included:             <ul style="list-style-type: none"> <li>- WCB’s former Chair/former Chair of the Investment Committee was also Chair of the Investment Committee of Partner A;</li> <li>- WCB’s former CIO also chaired the Board and the Investment Committee of Partner C;</li> <li>- The WCB Investment Committee’s Advisor was the CEO of Partner A and the promoter of the ABC Fund;</li> <li>- Partner A, an investor in ABC Fund, owned 65% of the management company, and 50% of the ABC Fund development corporation (which was proposed to renovate, develop and redevelop the ABC Fund properties for a fee); and</li> <li>- Partner B, an investor in ABC Fund, contributed an asset that it owned to the initial transaction rather than cash, owned 35% of the management company, and 50% of the development corporation.</li> </ul> </li> <li>• By actively pursuing a transaction such as ABC Fund amidst conflicting roles, concurrent relationships, and considerable concerns leading up to the transaction’s finalization, WCB placed their public reputation, and monies of the WCB, at risk.</li> <li>• In spite of WCB’s former Chair and the Investment Committee Advisor leaving the room in order to avoid a conflict of interest when ABC Fund was being discussed by the Investment Committee, we believe that their advocacy in favour of the ABC Fund investment was an influence on the Committee’s ongoing deliberations.</li> </ul>

Objective	Report Section	Conclusions
		<ul style="list-style-type: none"> <li>• Given the concerns expressed by so many, June 2003 was too soon in the development of the ABC Fund investment for the WCB Investment Committee to be asked to approve the notion of proceeding to “the next stage”.</li> <li>• It is unclear why WCB structured the ABC Fund investment with the Partner A and Partner B as the owners of the management company. It begs the question as to why WCB did not simply sponsor the R/E Consultant as the property manager along the lines of how the investment was initially contemplated in December 2001. By the time the investment was booked in July 2004, all of the changes needed in order to be able to accommodate the ABC Fund investment in accordance with the ABC Fund management company structure had cost WCB time, energy and money.</li> <li>• Conflicts of interest made for difficulties for Investment Department staff, and could have led to poor decision-making. It should not have been left to the Director, Investments to be moved to remind her superiors, in a June 20, 2003 memo, that <i>“it is important for WCB to do independent due diligence of the project, as our interests and the interests of the promoters are not entirely the same”</i>.</li> <li>• The three Winnipeg-based real estate investments were being managed appropriately, including regarding the maintenance of files, in accordance with R/E Consultant’s Agreement.</li> </ul>

## 3.0 Introduction

### 3.1 INITIATION

A review of the Workers Compensation Board of Manitoba (WCB) was undertaken by the Office of the Auditor General (OAG) in response to a number of concerns which were brought to our attention, regarding issues of: Board Governance; Human Resources; and Investment Management.

On September 30, 2004, letters were provided to the former Chair of the WCB and to the Minister charged with the administration of The Workers Compensation Act confirming that the OAG planned to review these concerns.

This review was conducted under the authority of The Auditor General Act and The Workers Compensation Act as follows:

- Section 9(1) of The Auditor General Act, which states:
 

*“The Auditor General is the auditor of the accounts of the government, including those relating to the Consolidated Fund, and must make any examinations and inquiries that he or she considers necessary to enable the Auditor General to report as required by this Act.”*
- Section 14(1) of The Auditor General Act, which states:
 

*“In carrying out his or her responsibilities under this Act, the Auditor General may examine and audit the operations of a government organization with regard to any of the following matters:*

  - a) whether financial and administrative provisions of Acts, regulations, policies and directives have been complied with;*
  - b) whether public money has been expended with proper regard for economy and efficiency;*
  - c) whether the Assembly has been provided with appropriate accountability information;*
  - d) whether the form and content of financial information documents is adequate and suitable.”*
- Section 69(2) of The Workers Compensation Act, which states:
 

*“...the Lieutenant Governor in Council or the Auditor General may at any time order an audit of or investigation into the accounts or affairs of the board...”*

### 3.2 OBJECTIVES AND SCOPE

Our objectives were as follows:

#### **Board Governance (Section 5.0)**

- To review the board governance practices of the WCB Board of Directors (the Board), including the Committee roles and responsibilities, and the frequency of Board and Committee meetings.
- To review WCB Board of Director per diems and expenses.

## **Human Resource (HR) Practices (Section 6.0)**

- To review allegations regarding inappropriate HR practices.
- To conduct an organizational review of HR practices related to senior management positions at WCB.

## **Investment Management (Section 7.0)**

- To review private placement investment and Winnipeg-based real estate investment transactions, as well as investment consultant expenses.
- To review conflict of interest with respect to investment activities of the WCB.

This review was conducted from October 2004 through November 2005 and included such tests and other procedures that we determined were necessary to address the concerns raised, and to address the issues that arose during the course of our work.

Numerous interviews were conducted and extensive documentation was reviewed including interviews with current and former WCB staff and external contractors providing service to the WCB. We reviewed information primarily for the period from January 1, 1999 to June 30, 2004. In some instances, our review was extended to December 31, 2004.

In examining the Board governance practices of the Board, our work consisted of a review of the Board's By-laws, meeting minutes, as well as governance policies and procedures. We examined six years of Board activity, from January 1999 to December 2004. Interviews were held with both current and former Board members who served on the WCB Board during that time period, for a total of 20 Board member interviews. In addition, interviews were held with current and former members of the WCB's Investment Committee. We also held a number of discussions with both the current Acting Chair and the former Chair of the Board, and met with the former Minister charged with the administration of The Workers Compensation Act. Further, issues of governance and Board activities formed a part of our discussions in interviews held with both current and former WCB staff.

We contracted with a firm knowledgeable of, and with experience in, human resources and respectful workplace issues to review the HR concerns and conduct a review of HR practices at WCB. The review included an analysis of the following:

- Relevant policies regarding respectful workplaces;
- Reasons for turnover at senior management levels since 1999;
- Staffing practices at senior management levels to assess equity and fairness;
- Work environment at senior management levels; and
- Whether WCB was a respectful workplace at senior management levels.

We also contracted with an individual knowledgeable of investment management practices to conduct a review of WCB's investment process and policy as it relates to private placements and real estate investments.

An assessment of WCB's programs, its claims process and procedures, and the results of its operations were outside the scope of this review.

### 3.3 ACTS AND OMISSIONS OF THE WCB RESTRICTING OUR WORK

During our review, the OAG encountered several instances of acts and omissions of the WCB and its representatives which unduly restricted our work. Throughout the initial stages of our work there was a strong reluctance on the part of some WCB officials to provide original records and supporting documentation until that documentation was reviewed by WCB senior representatives. These incidents were communicated to the Minister charged with the administration of The Workers Compensation Act and to the Deputy Minister of Labour and Immigration. The Minister and the Deputy Minister took steps to address the concerns raised by the OAG and encouraged the WCB and its officials to cooperate fully with our Office during this review.

Several of the persons interviewed by our Office were in significant distress, and indicated significant apprehension about their careers and/or reputations if WCB were able to link any of our findings to them as individuals or even if WCB were aware of the fact that they had been interviewed.

One particular incident warrants mentioning in this report:

- On January 20, 2005, the former Chair of the WCB telephoned a consultant engaged by the OAG to assist with the review, at her home during the evening. Inappropriate remarks were made to the consultant, and the consultant was left with the clear impression that her career and reputation were in jeopardy if the report produced for the OAG were to be unfavourable to WCB or its former Chair.
- The OAG verbally communicated this incident to the Deputy Minister of Labour and Immigration on January 21, 2005.
- On January 24, 2005, the OAG received a letter dated January 22, 2005 from the former Chair of the WCB offering a full apology to the consultant, and an assurance that events such as described above would not recur. This letter also indicated his personal assurance of full and professional cooperation with the OAG.
- The OAG documented this incident in a letter to the responsible Minister dated February 3, 2005.

The OAG considers this incident involving our consultant to be unacceptable and constituted interference with our review.

### 3.4 SUBSEQUENT EVENTS

Throughout our report, we refer to The Workers Compensation Act (The Act) which came into effect in 1992 and was in effect at the time we began our review. However, during our review, a legislative review process was ongoing and The Act has since been revised. Bill 25 passed third reading in the legislature in June, 2005 and the revised Workers Compensation Act is awaiting proclamation. As a result of the revisions to The Act, numerous changes are being undertaken by the WCB. We note that several of the changes may serve to address some of the issues noted in our report.

Some of the governance changes in Bill 25 include: that the Investment Committee will be accountable to the WCB Board of Directors; the Deputy Minister of Finance will no longer be a member of the Investment Committee; a Board member other than the WCB Chairperson will be required to chair each Board Committee; a stand-alone Audit Committee will be required; and there will be a requirement that Board members be appointed for up to 4-year, staggered terms.

During our review, the WCB Chair announced his retirement in February 2005, and as such, is referred to as the former Chair throughout our report. An Acting Chair was appointed in February 2005.

## 4.0 Background

### 4.1 ABOUT THE ORGANIZATION

#### Canadian Context

In Canada, workers compensation is a system of compulsory no-fault insurance for workplace injuries. The system is administered by statutory corporations or commissions established under provincial or territorial legislation.

The principles of Canadian workers compensation are influenced by a report of Sir William Ralph Meredith, which was issued in 1913. The fundamental principles in the Meredith report, which continue in Manitoba today, include:

- Workers gave up their right to sue employers in return for the security of compensation;
- Compensation is payable to injured workers regardless of fault of either the workers or the employers who fund the system;
- In return for immunity from suit, covered employers wholly fund the compensation system through premiums or assessments paid into an accident fund maintained by the workers compensation board; and
- The workers compensation system in Manitoba is administered by the WCB, an independent agency with exclusive jurisdiction to determine all matters under The Workers Compensation Act (The Act).

#### Manitoba

The WCB is an injury and disability insurance system for workers and employers, paid for by employers. The WCB operates under the authority of The Act.

In accordance with provisions of The Act, the WCB is responsible for:

- administering payments to injured workers and suppliers of services to injured workers;



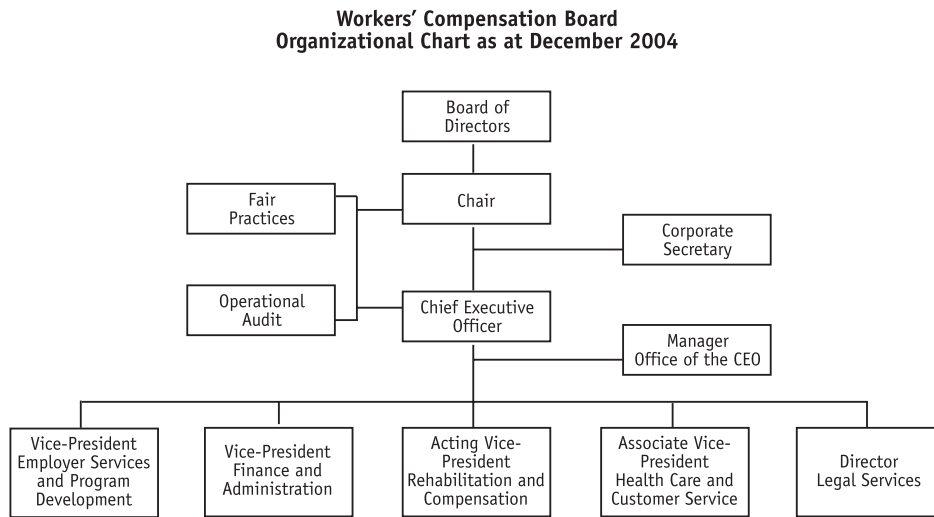
- levying and collecting premiums from established classes of employers in amounts sufficient to cover the current and future costs of existing claims; and
- investing surplus funds.

The mission of WCB is “to provide superior compensation services to Manitoba workers and employers in a manner that is sensitive, responsive and effective in order to minimize the impact of workplace injuries”.

According to WCB’s 2004 Annual Report, WCB’s insurance coverage applies to approximately 384,500 workers in Manitoba, employed by 25,110 registered employers.

Figure 1 sets out the organization chart for the WCB as at December 2004.

FIGURE 1



Source: WCB

## 4.2 FINANCIAL INFORMATION

According to WCB’s 2004 Annual Report, it is one of the few fully-funded WCBs in Canada, with reserves of \$70 million, with Manitoba employers enjoying the lowest average premium rate of any Canadian province.

Figure 2 presents WCB’s Balance Sheet information, highlighting that WCB has maintained an overall surplus during the period of our review, which at December 31, 2004 was \$70.5 million. The total surplus includes the Rate Stabilization and the Accident Fund balances. According to the audited financial statements of WCB for the year ended December 31, 2004, the \$36.0 million balance in the Rate Stabilization Fund was transferred to the Accident Fund Reserve.

Also in 2004, WCB set up a new concept called Other Comprehensive Income (OCI) to be in accordance with new accounting standards. OCI includes the unrealized gain/loss when an investment’s fair value changes during the year. When the investment is sold, the

realized gain is re-classified from OCI to investment income. The accumulated OCI balance as at December 31, 2004 was \$60.0 million as shown in **Figure 2**.

**FIGURE 2**

Workers Compensation Board Balance Sheet as at December 31, 1999 to 2004						
	(000s)					
	1999	2000	2001	2002	2003	2004
<b>Assets</b>						
Cash	\$ (1,210)	\$ 1,500	\$ 2,025	\$ (371)	\$ 1,513	\$ 2,079
Receivables and other	20,823	21,881	22,694	23,322	27,938	30,864
Investments	677,312	704,353	712,531	712,634	699,276	785,871
Deferred assessments	26,805	23,348	20,872	20,899	22,534	22,870
Capital assets	13,493	13,665	13,046	12,484	12,363	11,844
	<u>\$737,223</u>	<u>\$764,747</u>	<u>\$771,168</u>	<u>\$768,968</u>	<u>\$763,624</u>	<u>\$853,528</u>
<b>Liabilities and Surpluses</b>						
Payables and accruals	\$ 9,664	\$ 12,080	\$ 12,896	\$ 15,817	\$ 17,528	\$ 19,562
Benefit liabilities	650,437	675,084	683,131	677,965	690,123	703,447
Total liabilities	<u>660,101</u>	<u>687,164</u>	<u>696,027</u>	<u>693,782</u>	<u>707,651</u>	<u>723,009</u>
Rate stabilization fund	57,104	57,565	55,123	55,168	35,955	-
Accident fund reserve	20,018	20,018	20,018	20,018	20,018	70,491
Accumulated other comprehensive income	-	-	-	-	-	60,028
Total surpluses	<u>77,122</u>	<u>77,583</u>	<u>75,141</u>	<u>75,186</u>	<u>55,973</u>	<u>130,519</u>
	<u>\$737,223</u>	<u>\$764,747</u>	<u>\$771,168</u>	<u>\$768,968</u>	<u>\$763,624</u>	<u>\$853,528</u>

Source: WCB's audited financial statements

The Statement of Operations information presented in **Figure 3** shows WCB's annual operating surplus (deficit) during the period of our review.

**FIGURE 3**

Workers Compensation Board Statement of Operations for the years ended December 31, 1999 to 2004						
	(000s)					
	1999	2000	2001	2002	2003	2004
<b>Revenue</b>						
Premium revenue	\$129,152	\$135,970	\$143,082	\$146,045	\$162,591	\$177,897
Investment income	61,833	70,357	54,070	33,841	21,879	42,218
Total revenue	<u>190,985</u>	<u>206,327</u>	<u>197,152</u>	<u>179,886</u>	<u>184,470</u>	<u>220,115</u>
<b>Expenses</b>						
Claim costs incurred	135,264	157,502	149,729	131,910	155,533	161,317
Operating expenses	42,445	44,907	47,389	47,931	48,150	49,140
Total expenses	<u>177,709</u>	<u>202,409</u>	<u>197,118</u>	<u>179,841</u>	<u>203,683</u>	<u>210,457</u>
Deferred assessments	(4,772)	(3,457)	(2,476)	-	-	-
<b>Operating surplus (deficit)</b>	<u>\$ 8,504</u>	<u>\$ 461</u>	<u>\$ (2,442)</u>	<u>\$ 45</u>	<u>\$ (19,213)</u>	<u>\$ 9,658</u>

Source: WCB's audited financial statements

### 4.3 WCB BOARD OF DIRECTORS

A corporate-style Board of Directors was introduced to the WCB in 1990. All members of the WCB's Board of Directors, including the Chair, are appointed by the Lieutenant Governor in Council, through an Order-In-Council.

The WCB's Board of Directors consists of a total of 10 members: three members representative of employers, three members representative of workers, three members representative of the public interest, plus a Chair. The CEO is a non-voting member of the Board of Directors.

The Act specifies that the Board of Directors shall:

- approve and superintend the policies and direction of the board, including policies respecting compensation, rehabilitation, assessment and appeal procedures;
- consider and approve operating and capital budgets of the board;
- plan for the future of the compensation system;
- establish and give direction to committees that consist of members of the Board of Directors; and
- appoint a person to be known as the Chief Executive Officer.

The Act requires the Board of Directors to establish a Policy Committee composed of the Chair and equal numbers of representatives of workers, employers, and the public interest, whose function is to develop policy for the consideration of the Board of Directors.<sup>2</sup>

The Act also requires an Investment Committee be established to *"regularly review the investments in which the accident fund is invested and, ... shall give directions in writing, signed by the chairman, as to the investments in which moneys in the accident fund and available from time to time for investment shall be invested"*. The Investment Committee consists of the Chair of the Board of Directors (or a person designated by the Chair) who serves as the Committee's Chair, the Deputy Minister of Finance, and a person *"representative of the views of those upon whom assessments are levied"*.<sup>3</sup>

The establishment of all other Committees of the Board is at the discretion of the Board. At the time of our review, the Board had two other Committees in place: the Finance Committee and the Service Committee.

The WCB Board of Directors has enacted two By-laws: By-law #1 relating to the conduct of its affairs; and By-law #2 relating to confidentiality and conflict of interest of the Board of Directors.

<sup>2</sup> See Section 51.1(2) and (3) and Section 59(1) of The Workers Compensation Act.

<sup>3</sup> See Section 95(2) and Section 95(4) of The Workers Compensation Act.

#### 4.4 INVESTMENT BACKGROUND – PRIVATE PLACEMENT AND REAL ESTATE

The mix of WCB’s investments by asset classes as at December 31, 2004 is summarized in **Figure 4**.

**FIGURE 4**

Workers Compensation Board Investments by Asset Classes as at December 31, 2004	
	Market Value (\$million)
Private Placements (19)	\$ 23.9
Real Estate in Manitoba (5)	15.7
	<u>39.6</u>
Cash and accrued income	1.7
Other Real Estate	58.2
Canadian Equity Managers	167.6
U.S. Equity Managers	137.6
International Equity Managers	100.3
External Fixed Income Managers	280.9
Total assets	<u>\$785.9</u>

Source: WCB investment records

#### Statement of Investment Policies and Objectives (“SIPO”)

WCB produces a SIPO document (**Appendix A**) periodically with the most recent version dated January 2005. The SIPO governs investment policies and objectives for all of WCB’s invested assets including private placements and real estate.

Earlier versions of SIPO – February 2004, March 2002, and April 2000 (amended) – indicate the steady and continuing development and improvement of WCB’s investment philosophy, policies, objectives, and certain processes and procedures over several years.

#### Private Placement Investing

WCB has been investing in private placements for a number of years. As at December 31, 2004, WCB had 19 individual private placement investments (in 14 separate investments/fund families) with a market value of \$23.9 million. Four private placements have commitments as at December 31, 2004 for an additional \$16.4 million of funding. Of the 14 fund families, only one is not located in Manitoba.

Private placements normally are considered part of the Canadian venture capital and private equity industry. Glossary of Terms providing industry definitions and other relevant information is included in **Appendix B**.

## Real Estate Investing

WCB began investing in real estate in 1989 when minority positions in 10 properties were acquired from the Alberta Government Teachers Fund. Since that time, significant changes have occurred in the real estate portfolio.

The total portfolio grew in size to \$73.9 million market value as at December 31, 2004, representing 24 individual properties, with another \$6.0 million in future commitments yet to fund as at that date. Of this amount \$15.7 million was invested directly in Manitoba real estate.

Other properties were located across Canada, except for Quebec and Atlantic Canada, with 94% in industrial, office and retail properties in terms of type.

Properties were managed by 7 asset managers. The largest of the asset managers was responsible for 63.6% of the market value of the assets managed as at December 31, 2004. The next largest asset manager managed 8.8% of the portfolio. A real estate consultant (R/E Consultant) managed the 7 asset managers for WCB pursuant to a Portfolio Management Agreement (see **Appendix C**).

WCB held its ownership interest positions in individual properties both directly and indirectly. Direct holdings were through WCB Realty Limited, a wholly-owned subsidiary of WCB. As at December 31, 2004, 8 properties were directly held.

Indirect real estate interests were held by-way-of a privately held real estate company owned by 37 of Canada's largest institutional investors. Specially created participating bonds flow property income to investors like WCB, allowing participants to trade, and increase or decrease their position in a property through the sale or purchase of the participating bond via a well-developed secondary market for the bonds.

## 5.0 Governance

### 5.1 BOARD GOVERNANCE

As one objective of our review, we examined the governance practices of WCB's Board of Directors (the Board), from January 1999 to December 2004. Our work consisted of a review of the Board's By-laws, meeting minutes, governance policies and procedures, as well as numerous interviews with both the current and former Chair, current and former Board members, current and former Investment Committee members, current and former WCB staff, and the former Minister charged with the administration of The Workers Compensation Act (Minister).

In conducting this review, the OAG utilized the attributes of effective corporate governance that have been developed in our previous reports.<sup>4</sup> Effective corporate governance is built upon four pillars: Stewardship; Leadership; Responsibility; and Accountability. Governance practices relate to how a governing body (most often, a Board of Directors) leads and oversees an organization. It requires appropriate mechanisms be established by a Board of Directors to enable effective decision making, ensure clear

<sup>4</sup> Detailed discussion on OAG's governance attributes available on our website: [www.oag.mb.ca](http://www.oag.mb.ca).

accountability, and provide for regular review and assessment of management and operations. Although the specific practices, functions and activities of a Board of Directors will, and are expected to, differ based on the particular context of an organization, a Board's work must ensure that the key governance elements of setting strategic direction and providing effective corporate oversight are performed.

## **OBSERVATIONS**

- The WCB's Board consists of a total of 10 members: three members representative of employers, three members representative of workers, three members representative of the public interest, plus a Chair. The CEO is a non-voting member of the Board.
- It was evident from our discussions with all former and current Board members that they are highly committed to the WCB and to achieving its organizational goals of meeting the needs of injured workers in Manitoba. Our review of Board minutes found that the Board did not have any issues with respect to attendance or achieving quorums.

## **Board Structure and Appointments**

- A distinctive aspect of WCB's Board is its tri-partite structure, as a representative board of the three key stakeholders in the compensation system: employers; workers; and the public interest. All Board members indicated they found the Board's tri-partite structure to be generally effective, with an adequate balance of stakeholder interests. The governance concerns that were raised by Board members and staff were not specifically attributed to the Board's tri-partite structure.
- All members of the Board, including the Chair, are appointed by the Lieutenant Governor through Order-In-Council. The Board's tri-partite structure results in a unique appointment process, where the Minister solicits input from stakeholder groups representing both employers and workers. The Act requires government to consult with employers and labour when making employer, labour, and public interest appointments to the WCB. When advised of upcoming vacancies on the Board, the Minister writes to the various stakeholder groups, who put forward nominations for their representative. No specific selection criteria are provided, other than a general instruction that nominees be "*reflective of this Government's philosophy of equal, diversified and gender-balanced representation*". Consistent with common practice, the perspective of WCB's Chair regarding nominations is also solicited. The Minister selects the nominees, and forwards the recommendation to the Cabinet Committee on Agencies, Boards, and Commissions.
- A number of concerns were raised in our interviews with respect to the transparency and fairness of the appointment process. As these concerns varied dependent on the stakeholder group, each is discussed individually below:

*Representatives of Workers (3)*

- The Minister solicits nominations for all worker representatives from the Manitoba Federation of Labour (MFL). The MFL submits only one nominee per vacancy and our review found that the nominee is always appointed to the Board. By providing only one nominee per vacancy, the MFL does not put forward alternatives for the Minister's consideration. Worker representatives nominated by the MFL have generally been individuals knowledgeable of the WCB claims process, as a result of their professional involvement in WCB claims advocacy.

*Representatives of Employers (3)*

- In years prior to 2004, all employer nominations were solicited from the Employers Task Force on Workplace Safety and Workers Compensation (ETF). As a means of obtaining more input, the Minister has, since 2004, solicited nominations for employer representatives from a variety of organizations including the Regional Health Authorities, the Business Council of Manitoba, the Manitoba Chambers of Commerce, Winnipeg Chamber of Commerce, the Manitoba Employers Council and the ETF. Each organization is asked to put forward more than one nominee per vacancy and the Minister selects the successful nomination from among the various names put forward.

*Representatives of the Public Interest (3)*

- The Minister's process for selecting public interest representatives is more ambiguous. Several concerns were noted in our interviews with respect to the process for recruitment and selection of public interest representatives. In one particular situation, a public interest representative questioned why their appointment was directly handled by the MFL, including the initial request to serve, and the request for reappointment. At least one other public interest representative was nominated by the MFL.
- Section 50.2(3) of The Act indicates that Board members are "*appointed for a fixed period not exceeding five years*". The Act does not specify nor limit the length of time that may be served by a Board member, nor the number of reappointments that can occur. We noted that, over the period of our review, Board members were generally appointed for terms of either one, two, or three years. Several concerns regarding the short tenure of some Board appointments were raised in our interviews, as it is difficult for any Board member to make a significant contribution after only one year, given the size and complexity of the compensation system. Having experienced Board members was perceived as a strong advantage in representing the interests of a stakeholder group.
- Turnover for Board members representing employers and the public interest has been significantly higher than for Board members representing workers. Over the course of our review period, there have been 7 individuals representing employers, and 8 individuals representing the public interest. During that time period, only two

changes have occurred in Board members representing workers; one due to retirement and one due to the individual being appointed to the WCB Appeals Commission.

- The Board has not developed a skills/competency framework of the various qualifications that would best complement the functioning of the Board. When Board vacancies arise, this would be useful information for the Minister in order to assist and inform their decisions with respect to Board member appointments. It could also be provided to all stakeholder groups in order to assist them in selecting their nominations. It was noted in our interviews that the Board lacked members with financial training or financial expertise. Other key competencies that may add value to the Board's deliberations include executive management experience, as well as investment expertise.
- The appointment process for the Chair is not specifically dealt with in The Act. It appears that Section 50.2(3) of The Act regarding Board member appointments is also applicable to the Chair. The former Chair was originally appointed in 1992 for a period of 3 years, reappointed in 1995 for 2 years, reappointed in 1997 for 3 years, reappointed in 1999 (prior to the end of the previous term) for 3 years, and reappointed in 2003 for 2 years. The former Chair retired in February 2005, after serving as Chair of WCB's Board for more than 12 years. The current Chair was appointed in an Acting capacity in February 2005, for a term ending December 2005.

### **Board Orientation and Training**

- Our review noted that many of the former and current Board members had limited experience in governance of a large public sector organization when appointed. Some had little prior knowledge of the WCB and the compensation system. Several Board members told us they were overwhelmed when first appointed to the Board, and that it took a considerable amount of time to understand the organization and its governance issues. This was noted especially by public interest representatives, who may not bring experience directly related to WCB from their professional careers, as do worker and some employer representatives.
- Several Board members indicated that the process for orienting new Board members could be improved. We noted that no consistent orientation process exists for new Board members. Most are provided with a large package of information that includes The Act, the Board governance manual, and WCB policies and procedures. Some new Board members told us they attended an orientation meeting with the CEO and/or senior management, however not all Board members took advantage of this opportunity for a variety of reasons.
- We noted that the Board is not provided with ongoing training and development opportunities specifically related to governance. Given that most Board members had no prior experience on the Board of a large private or public sector organization, the need for governance



training and developmental opportunities is amplified. As corporate governance standards are evolving, all Board members can benefit from ongoing developmental opportunities in governance, as well as training in financial literacy.

- Board members are provided the opportunity to attend the annual congress of the Association of Workers Compensation Boards of Canada (AWCBC). In general, one Board member from each stakeholder group, the Chair, and some senior staff attend the congress each year.
- We noted a Board Resolution passed in April 2001, to *“retain the assistance of a facilitator to conduct a seminar on Corporate Governance to be attended by members of the Board of Directors and WCB Executives”*. This was duly noted on the Board’s Work Plan as a “To Do” item in September 2001. At the time of our review, it was still being carried forward on the Work Plan. No Board member ever appeared to question the lack of execution, and most could not recall that it was on their Work Plan, even though it was noted in their agenda package each month for over four years. We have been informed that the Board has recently held a governance session with an external facilitator, at the direction of the current Acting Chair.

**Board Accountability and Strategic Planning**

- When asked to whom they were accountable, Board members provided a wide variety of responses. This lack of clarity with respect to the Board’s primary accountability is cause for concern. Given the representative structure of the Board and the multiple stakeholders in the compensation system, it is especially important that the Board discuss and clarify to whom and for what it is primarily accountable. This helps facilitate the exercise of good governance, by ensuring that, although representative of various stakeholder interests, the Board’s decisions are made in the best interests of the WCB as an organization. Such discussions often occur as part of a Board’s strategic planning exercises.
- The Board held two strategic planning retreats each year, which was generally attended by all Board members, as well as the CEO and senior staff. A multi-day planning session was held each year at an off-site location within the province; and a one-day update session was held at an off-site location within the city. All Board members perceived these planning sessions to be valuable in setting strategic priorities, and receiving updates on strategic initiatives.

**Board Information**

- All Board members felt that they were provided with comprehensive information, and professional reports from WCB management and staff. Board members indicated they were satisfied with the timeliness of receiving Board information, and many noted that it was well organized and easily understood.
- Board members received a large agenda/information package prior to Board meetings, which included all minutes/information from all

Committee meetings held in the previous month. Some Board members did indicate that the volume of information was sometimes overwhelming, and that not all Board members had read the information prior to Board meetings. Even those who did not identify the volume of information as a serious concern, noted that the large amount of reading material caused them to focus only on the aspects that were of interest/relevant to them. This is a common dilemma for Boards provided with too much information, as it may be difficult for Board members with many other commitments, to devote the time necessary to fully review and analyze the information prior to Board meetings.

- Board members indicated being satisfied with the financial information provided, and felt that staff did an excellent job of providing financial updates and explaining any budget variances. The Finance Committee reviewed budgets and financial information prior to it being provided to the Board. We found that when asked about particular financial documents, many Board members did not recall them, or noted that they did not review the financial portion of their information package in detail; relying instead on the Finance Committee to ensure financial information was complete.
- All Board members indicated that they did not hesitate to ask for more information when they felt it was required, and all noted that they had never felt that WCB management or staff hesitated in providing the extra information as needed. Further, no Board member indicated that they had ever felt pressure to make a decision prior to all the information being provided.

#### **Board Committees**

- The Act requires the Board to establish a Policy Committee composed of the Chair and equal numbers of representatives of workers, employers, and the public interest, whose function is to develop policy for the consideration of the Board of Directors.<sup>5</sup> The establishment of all other Committees of the Board is at the discretion of the Board. At the time of our review, the Board had two other Committees in place: the Finance Committee and the Service Committee.
- The Board's By-law #1 specifies the mandates and functions of the three Committees. Each Committee generally meets monthly, and is composed of one Board member from each stakeholder group, plus the Chair, who also acts as Chair of each Committee.
- Having the Chair of the Board also serve as Chair of all Committees is a governance practice that is unique to WCB. We were given a number of reasons for this practice, including that it ensured continuity of discussion among the Committees, and that the Chair was best able to facilitate meetings. While many Board members noted they had never questioned the practice, some concerns were expressed with the over-concentration of power in the position of Chair as a result of this

<sup>5</sup> Section 51.1(2) and Section 51.1(3) of The Workers Compensation Act.

practice. We note The Act requires that the Chair serve as Chair of the Policy Committee and requires either the Chair or designate to act as Chair of the Investment Committee. Our review of four other large government enterprises<sup>6</sup> in Manitoba found that none follow the practice of the Chair chairing all Committees, nor is it considered a desirable practice in current governance literature, especially with respect to a Board's Audit Committee.

#### *Policy Committee*

- The Policy Committee, which is established under Section 51.1 of The Act, *“reviews and recommends changes to existing policy and initiates new policy through consultation with stakeholders of WCB”*.<sup>7</sup> No serious concerns were raised during our interviews with respect to the functioning of the Policy Committee. Our review noted that the Committee's policy role was sometimes limited to reviewing minor wording changes to existing policy.
- The Policy Committee also serves as the Board's Personnel Committee. In 1999, the Board amended By-law #1 to give the Committee responsibility *“to consider Human Resource matters on behalf of the Board”*. Our review noted that the Committee's main human resource functions were with respect to coordinating the annual CEO evaluation process, reviewing CEO compensation, and when required, coordinating the CEO hiring process. The Committee played a limited role in terms of dealing with human resource issues impacting the organization, simply receiving updates and statistical information.

#### *Finance Committee*

- The Finance Committee was established to *“review the financial position of the WCB including the annual budget, assessment rates and related financial policies”*.<sup>8</sup> No serious concerns were raised during our interviews with respect to the activities of the Finance Committee, and all Committee members noted that they received good financial information and explanations from WCB's Finance Department.
- The Finance Committee also serves as the Board's Audit Committee. In April 2003, the Board amended By-law #1 to *“enhance the Audit Committee responsibilities of the Finance Committee”*. When asked what changed in the activities of the Committee as a result, no Committee member was able to identify any extra duties that were performed or required. The Finance Committee does perform some duties typical of Audit Committees; however, Audit Committee meetings or functions are not specifically designated as such. In recent years, governance literature has highlighted that having an independent, financially literate Audit Committee, responsible for all published financial and performance reporting of the organization, the relationships with

<sup>6</sup> Manitoba Public Insurance Corporation, Manitoba Hydro-Electric Board, Manitoba Liquor Control Commission, and the Manitoba Lotteries Corporation.

<sup>7</sup> WCB Annual Report, 2004.

<sup>8</sup> WCB Annual Report, 2004.

external and internal auditors, and the oversight of internal controls and risk management, is a key element to good governance.

- We noted that no members of the Finance Committee during the period of our review, had expertise in financial management and/or accounting, nor was any financial literacy training ever provided to Committee members.

#### *Service Committee*

- The Service Committee, which was amalgamated with the Grants Committee in 1999, *“assists the WCB’s administration in accelerating and monitoring service improvements and recommends approval of funding under the WCB’s Community Initiatives and Research Program (CIRP)”*.<sup>9</sup> We noted that the majority of the Service Committee’s time is spent on administrative activities related to the approval of funding for the CIRP. The Committee’s other functions include reviewing customer service issues, client polling information, and quarterly reports of the Fair Practices Advocate, most of which could simply be provided to the full Board as information.
- Several Board members, including some who had previously served on the Service Committee, raised concerns with respect to the need for and the functioning of the Service Committee. In terms of rationale for the establishment of the Service Committee, several members noted that it was largely put in place so that all Board members could be assigned to a Committee, and thereby receive the same amount of per diems.
- Many concerns were also expressed in our interviews with respect to the level of detailed administrative involvement of the Service Committee’s role in the CIRP program. The CIRP provides \$1 million annually to projects and research initiatives that are intended to enhance safety and prevention, or help injured workers. We found no documented rationale for the origin of the program, nor for the level of support, which was originally set at \$1 million, and has not changed since the program was initiated. Most interviewees told us the CIRP program was initiated as a “trade-off” to workers when employers received a rebate. The \$1 million was perceived as a way for the Board to “give back to workers” as well.
- Originally, the CIRP program had little criteria or process. However in recent years, the Service Committee has done a great deal of work in establishing the criteria and terms of reference for the proposals, as well as establishing a phased review and approval process. The Service Committee handles all aspects of the program, including monitoring progress reports of all projects, reviewing in detail all proposals submitted each year, deciding which progress to the next stage of the process, and ultimately which will be recommended to the Board of

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<sup>9</sup> WCB Annual Report, 2004.

Directors for final approval. Some interviewees noted that, while final funding approval rests with the Board, WCB staff could be tasked with the majority of these administrative functions.

### Board Culture

- All Board members told us that the Board was collegial and most felt it functioned well together as a team. Many Board members described the Board as “active” and “hands-on”. All Board members agreed that the Board operated in a non-adversarial, consensus-driven manner, even though discussions could on occasion be intense and animated. Credit for the collegial nature of the Board’s activities was attributed to the facilitation skills of the former Chair. Almost all Board members noted that they admired the former Chair for his wealth of experience and his abilities in facilitating and chairing meetings.
- The Board strived to achieve consensus in its decision making, and it was specifically noted to us that decisions were unanimous in 97% of cases, according to a statistical calculation completed by the Board’s Corporate Secretary. We were told this demonstrated how well the Board worked together and the collaborative approach of the Board, given its tripartite, representative structure. However, several Board members noted in our interviews that they felt too much emphasis was placed on achieving consensus, and there was substantial pressure to conform and not vote against a motion. We were told that the former Chair “*was almost entirely insistent on having unanimous votes*”, and some Board members noted this placed them in a difficult position when they disagreed, requiring them on occasion to abstain from voting rather than vote against a motion. Some Board members told us they hesitated to disagree unless it was of strong importance to them, and a few Board members noted that their unwillingness to vote in favor of a proposal caused anger to be directed towards them by the former Chair. A few Board members felt that this affected their reappointment to the Board.
- While we were told that the Board discussed issues at length and there was good participation and active debate at Board meetings, the Board’s discussion/debate is not recorded in the minutes. A few Board members indicated they had some frustration with Board discussions, in terms of the level of the debate, and whether all Board members understood what they perceived to be “the real issues”. The length of the Board meetings was not recorded until early 2004. Since that time, the duration of Board meetings is generally under two hours.

### Investment Committee

- The Act also requires an Investment Committee be established to “*regularly review the investments in which the accident fund is invested and, ... shall give directions in writing, signed by the chairman, as to the investments in which moneys in the accident fund and available from*

*time to time for investment shall be invested*". The Investment Committee consists of the Chair of the Board of Directors (or a person designated by the Chair) who serves as the Committee's Chair, the Deputy Minister of Finance, and a person "*representative of the views of those upon whom assessments are levied*".<sup>10</sup> This representative is appointed through Order-in-Council.

- The Act establishes the Investment Committee. However, The Act is not specific as to the accountability of the Investment Committee to the Board. In practice, the Investment Committee was not accountable to and did not formally report to the Board. The Board does not have any input into investment-related decisions, and decisions of the Investment Committee are not ratified nor approved by the Board. The linkage between the Board and the Investment Committee rests solely in the WCB Chair.
- Although the Board's Finance Committee receives quarterly updates on the financial position of WCB investments, neither they nor the Board receive copies of Investment Committee minutes, nor did the Investment Committee receive copies of Board minutes. Hence, it is not surprising that Board members were generally unaware of the specific activities of the Investment Committee.
- In our interviews, Board members were unclear as to whom the Investment Committee was accountable. Various responses were provided, with the majority assuming that the Investment Committee was accountable to government and the Minister, as the Deputy Minister of Finance was a legislated member of the Committee. Only a few Board members expressed concern over such a large part of the organization's financial activities being outside the purview of the Board; most indicated they had never questioned the governance structure of the Investment Committee until our review.
- Of greater concern, Investment Committee members themselves provided no consistent response as to whom the Investment Committee was accountable. While the former Chair indicated in our interviews that the Investment Committee was accountable to the Minister, the Committee members interviewed all indicated different accountabilities, including that it was accountable to the Board through the Chair. We noted a WCB press release dated December 11, 2003 stating that "*The Investment Committee... operates independently from government and the WCB Board of Directors...*". As such, the Investment Committee appears to operate with no accountability.
- The former Deputy Minister of Finance who served on the Investment Committee during the period of our review, did not indicate that there was direct accountability back to his Minister, and clearly indicated that the Investment Committee was not in direct contact with the Minister,

<sup>10</sup> Section 95(2) and Section 95(4) of The Workers Compensation Act.

nor did he perceive his role as that of communicating the Minister/government's direction to the Investment Committee.

- The current employer representative on the Investment Committee has significant investment and financial management experience which was highly praised by all interviewed as adding value to the Investment Committee. The investment expertise of other Investment Committee members was limited. We were told that one method for bringing needed expertise to the Investment Committee was to appoint non-voting "Advisors" who were paid a per diem rate to attend meetings. We were told these Advisors were selected by the former Chair; they were not appointed through Order-in-Council. Neither the Investment Committee members nor the Board of Directors were involved in the selection of Advisors. There were two Advisors during the period of our review, one of whom left the Committee for health reasons in 2001, and one who has not attended a meeting since November 2004.

### Frequency of Board Meetings

- Several concerns were raised with respect to the total number of meetings held by the Board, and the frequency of Committee meetings. As such, we conducted an analysis of all Board activity over the six year period of our review (see **Figure 5**). The total number of Board and Committee meetings held per year ranged from 58 to 73, for an average of approximately 63 meetings per year. This is a much higher number of meetings annually as compared to the four other large government enterprises in Manitoba we reviewed.<sup>11</sup>
- A Board member would be required to attend the monthly Board meeting (as well as the annual strategic planning sessions), and one Committee meeting each month. This would total an average of approximately 26 meetings per year. This is not that unusual or high an amount. However, the former Chair would attend all Board and Committee meetings, including those of the Investment Committee, for an average of approximately 63 meetings per year. This is much higher than the number of Board and Committee meetings attended by Chairs of other large government enterprises in Manitoba.<sup>12</sup>

<sup>11</sup> Manitoba Public Insurance Corporation, Manitoba Hydro-Electric Board, Manitoba Liquor Control Commission, and the Manitoba Lotteries Corporation.

<sup>12</sup> Manitoba Public Insurance Corporation, Manitoba Hydro-Electric Board, Manitoba Liquor Control Commission, and the Manitoba Lotteries Corporation.



FIGURE 5

Workers Compensation Board Number of Board and Committee Meetings Held January 1999 - December 2004						
Year	Board Meetings <sup>(1)</sup>	Finance Committee	Policy Committee	Service Committee	Investment Committee	Total
1999	15	12	17	15 <sup>(2)</sup>	14	73
2000	15	14	10	10	9	58
2001	14	11	14	11	11	61
2002	13	12	12	13	10	60
2003	13	11	11	15	11	61
2004	14	12	10	14	12	62
					Total	375

Source: WCB minutes

(1) Includes Board planning symposiums/retreats

(2) Includes meetings of a separate Grants Committee which was amalgamated with the Service Committee in 1999

- Given that the CEO would also be required to attend all meetings, as well as other senior staff who would have to provide information for the meetings, the frequency of Board and Committee meetings could be a significant burden on the organization. Our interviews with staff noted that they found the frequency of Board meetings, as well as the resulting demand on staff time, to be an issue.
- Our review of minutes of Committee meetings noted that some of the discussion/activity was at a largely operational level, and of a nature that did not always warrant a separate Committee meeting. There was considerable duplication of information that was provided to each Committee, as well as repeated at the monthly Board meeting. The level of detailed information provided to the Board about operational activities may have been a contributing factor to the Board and its Committees being overly involved in discussions of operational matters.

**Board - Management Relations**

- All Board members were positive about the level of professionalism of the senior management team and the quality of information provided to the Board by WCB staff. Most Board members told us they perceived the relationship with WCB staff at Board meetings to be open and collegial.
- Annual performance evaluations of the CEO are conducted by the Policy Committee. All Board members have input into the current evaluation process and were comfortable with how it was handled.
- In terms of the Board’s working relationship with the organization, many Board members raised serious concerns with the former Chair’s level of involvement in the day-to-day operational and management activities of the WCB. Many indicated it was clear “who was the boss” and “who ran the WCB.” Even Board members, who raised no concerns with this issue, acknowledged that the former Chair was highly involved and “active” in the organization.



- Numerous concerns were also raised in our interviews with WCB staff, who perceived “micro-management” by the Board, and specifically the former Chair, to be a significant issue for the organization. Although the current CEO indicated no concerns with the level of involvement of the former Chair, serious concerns were expressed by several current and former senior managers, as well as the former CEO. Many interviewees noted that the level of day-to-day involvement of the former Chair was excessive, blurring internal accountabilities, and creating confusion with respect to the authority of the CEO. Almost all WCB staff told us it was clear that the former Chair was the “real boss”.
- We noted that the former Chair had acted in a dual capacity as both Chair and CEO of the organization for a three year period prior to 1998 and for three months in 2000 during the leave of absence of the former CEO. Several Board members, as well as WCB staff, indicated that although a CEO was eventually hired, the former Chair was never able to “give up that role”. As one Board member noted, *“He’s the CEO regardless of whether there is actually another human being in that office called the CEO”*.
- Many Board members serving during the tenure of the former CEO noted that the relationship between the former Chair and the former CEO became strained. Several interviewees attributed this to the former Chair’s unwillingness to relinquish a role in WCB’s day-to-day operations. The former CEO was terminated by the Board in 2001, after raising significant governance concerns.
- Shortly after the termination of the former CEO, one Board member was asked by the Board to interview senior management to discuss and verify some of the concerns that had been raised by the former CEO. Our review of minutes noted a verbal report from the Board member on these interviews, but no written documentation was provided to the Board members. It was indicated in the minutes that concerns raised by senior management included the Board’s level of micro-management. This echoed concerns raised by the former CEO. No apparent action was taken by the Board to address the issue.

### Conflict of Interest

- The Board’s By-law #2 specifies how the Board of Directors deals with conflict of interest situations. Only a few Board members noted this By-law in our interviews; most were unable to recall whether a conflict of interest policy existed. We noted that Board members were not required to sign an annual declaration of conflict of interest form. Such forms can be a useful method to ensure that the conflict of interest policy and guidelines are discussed on an annual basis, and that a common understanding exists.
- Most Board members did not have specific concerns related to the handling of conflict issues during a Board meeting. We noted a few instances in the minutes where Board members declared conflicts of interest and excused themselves from the discussion.

- Several Board members did raise serious concerns of conflict regarding the current practice of appointing worker representatives to the Board, who in their professional capacities, also act as advocates in the WCB claims/appeal process on behalf of injured workers. This was perceived as a significant conflict of interest by many Board members, as well as by WCB staff. Although the institutional knowledge of these Board member/advocates can potentially add value to the Board's deliberations, the dual role creates a number of difficulties for the organization.
- By-law #2 discusses this conflict and the specific protocols/procedures that Board members/advocates must utilize when dealing with the organization. All worker representatives interviewed were clear on the protocols in place when they are dealing with the WCB in their role as advocates, and understood that the protocol was in place to ensure no undue influence was perceived by staff. However, our interviews with staff noted serious concerns with the difficulties created for the organization by the dual role.
- We reviewed documentation of a particular instance where a Board member/advocate did not follow the protocol established in By-Law #2 and was perceived to have acted inappropriately, creating a high level of concern among WCB staff. Our discussions with the Board member/advocate noted that the Board member did not perceive the situation as an issue as the Board member felt he/she was acting in his/her capacity as an advocate, not as a Board member. Such situations place WCB staff in a difficult position. This is an example of how, regardless of whether the Board member perceives it as a conflict or not, the perception of conflict may exist for staff.
- In 2004, a Legislative Review Committee was formed to review The Act. They submitted their report, *Working for Manitoba: Workers Compensation for the Twenty-First Century in February 2005*. Concerns of conflict were expressed in several interviews with respect to the former Chair simultaneously acting as Chair of the Legislative Review Committee. We were told that the selection was made due to the facilitation skills of the former Chair. However, the inherent conflict of this situation was noted by many interviewees, especially given the level of the former Chair's involvement with WCB operational matters. Our review of minutes noted one example of such conflict when the former Chair took personal exception to an issue raised in several submissions to the Committee, and noted to the Board that he would be responding personally in order to "clarify their misunderstanding."

### Relationship with Government

- The WCB's relationship with government is conducted predominantly through the Chair of the Board. The Chair and CEO hold regular meetings with the Minister. The Minister also receives regular Briefing Notes summarizing all Board decisions and activities. Board members indicated that they had no direct involvement with the Minister and did not generally attend meetings with the Minister.

- Several policy issues were noted in minutes as being brought to the Board's attention by the former Chair "at the request of the government." While most Board members perceived the government's involvement or direction with respect to WCB issues as a given, some Board members noted concerns with the level of involvement regarding certain initiatives.
- In 2001, serious concerns with respect to the WCB's governance practices and specific activities of the former Chair were brought to the former Minister's attention in writing by the former CEO. Although the majority of concerns were specifically in regards to the former Chair, the former Minister forwarded the information to the former Chair to handle, in conjunction with the Board. We were told that the former CEO had previously attempted to meet to discuss her concerns with the former Minister and that two scheduled meetings were cancelled: one by the former CEO as a result of a Board Committee meeting being called, and one by the former Minister. We were informed that the former Chair had communicated to the Minister that this was a matter to be addressed internally rather than by the Minister. The former Minister considered this to be a personnel matter. No follow-up was conducted by the former Minister to ensure the concerns were dealt with appropriately.

#### Board Evaluation

- The Board did not conduct any formal evaluation of its governance effectiveness and performance. Two Board members noted that one had been done many years previously, but no other Board member recalled such an assessment.
- As noted previously, when significant concerns were raised with respect to the Board's governance practices in 2001, the Board resolved to hold an externally facilitated session on governance. While this item has rested on the Board's Work Plan as a "To Do" item for over four years, no governance review was ever held during the tenure of the former Chair, and no further discussions with respect to improving or assessing the Board's governance were ever noted again in minutes.
- Most Board members felt that the Board was effective, because they were a very "active" and "hands-on" Board. However, throughout our review, divergent views were expressed on how the Board functioned. Some Board members credited the former Chair for the Board's effectiveness, and were supportive of his active, hands-on management of WCB affairs. Several other Board members indicated that the Board was overly controlled by the former Chair, and raised his over-involvement in the WCB operational matters as a governance concern. Interestingly, the divergent views reflected the various representation on the Board, with the majority of the concerns regarding the Board's governance practices being raised by public interest and employer representatives. Worker representatives expressed much higher satisfaction with the functioning of the Board.

## Conclusions

- In our opinion, when serious concerns are raised to a Minister with respect to the governance practices of the Board of Directors of a government enterprise, the Minister has a role in ensuring that the issues are addressed appropriately. Further, when the concerns are respecting the actions of a government-appointed Chair, we believe that it is incumbent on the Minister to take a proactive role in ensuring an independent review is conducted.
- A significant governance issue for the WCB was the over-involvement of the former Chair in the day-to-day operational and management activities of the organization. The former Chair had a high degree of control in the operational matters of the WCB. This is a significant governance concern, as it blurs the line between governance and management, and raises accountability issues for a CEO. This situation created serious concerns for many WCB staff. All Board members may not have recognized or been fully aware of the extent of the former Chair's involvement with staff on a daily basis, as Board members were generally involved in WCB issues only twice per month, at the Board meeting and their Committee meeting.
- In our opinion, the WCB's Board needs to modernize its governance practices to ensure that the principles of good governance are fulfilled. The Board's Committee structure requires review to ensure that all its Committees are fulfilling an appropriate governance and oversight role, rather than an operational role.
  - In general, the work of a Board Committee is utilized to enhance and inform Board decision making through the provision of well-examined information, which focuses on governance issues that add value to the strategic direction of the organization, or that assist a Board in ensuring its monitoring and oversight functions are adequately fulfilled. Dependent on the Committee's responsibilities, this may only require quarterly or even semi-annual meetings. A Committee should not meet monthly just for the sake of meeting.
  - In our opinion, the Service Committee fulfills an overly administrative role in the CIRP program, rather than a governance one. In order to more appropriately provide a governance role to the program, the Service Committee (or the full Board) would be involved in setting the annual priorities for the CIRP, reviewing the annual funding levels, and providing final approval of the proposals to be funded. With the priorities in place, WCB staff would be responsible for the administration of the program, including initial review and ranking of proposals, providing only those that meet the guidelines to the Board for review and final approval. The Board would be responsible for ensuring a formal evaluation of the costs/benefits of the CIRP is conducted, and documented.
  - Leading governance practices support having an independent, financially literate Audit Committee, separate from the Finance Committee. An Audit Committee should not be chaired by the Chair of the Board.

- WCB's Investment Committee operated with no clear accountability, which is a significant governance concern. An Investment Committee must be accountable to the Board of Directors, as it is inappropriate for a Board to not be involved in, nor have oversight of, such a large part of the organization's financial activities.
- The numerous concerns raised with the appointment process for selecting members to the WCB Board indicate that a review is needed. In our opinion, requiring each stakeholder group to provide the Minister with a slate of names from which to select qualified candidates and providing a matrix of competencies for the WCB Board to assist the Minister and stakeholders in the consultation process would help ensure that the appointments to the WCB are handled in a more open and transparent manner. The establishment of staggered terms, with a limited number of reappointments, is a reasonable approach to balancing the Board's need for continuity with the benefits of renewal. The appointment process must consider the conflict created by having worker representatives who perform dual roles as Board members and advocates for injured workers in the WCB claims process. This situation creates difficulties for the organization, and places WCB staff in potentially difficult positions.
- The strong emphasis on unanimous Board approval for all motions is a concern and it is unclear as to why it was considered such a necessity. While achieving consensus is an important and worthy goal, insistence on unanimous decisions could potentially create an environment where independent opinion is silenced. A Board of Directors by definition brings together disparate viewpoints and will, on occasion, even after thorough discussion of issues, find that viewpoints may not align, resulting in a vote. It is certainly not inappropriate for a Board member to vote against a motion, nor to have their negative vote recorded. This should not be perceived as taking away from the effectiveness or appropriate functioning of a Board.

## 5.2 BOARD PER DIEMS, EXPENSES AND OTHER COMPENSATION

We reviewed all per diem claims and expense reports, for the period January 1, 1999 to June 30, 2004, filed by Board members and the former Chair. In this section we also reviewed the former Chair's additional WCB compensation.

### 5.2.1 Board Member and Former Chair Per Diems and Expenses

#### **OBSERVATIONS**

- Section 50.2(4) of The Act provides the Lieutenant Governor in Council the authority to fix the remuneration of each Board member appointed, including the Chair. The Order-in-Council, which is the formal document appointing the Board of Directors of each government enterprise in Manitoba, usually includes details of the remuneration to be paid to each Board member appointed, including the Chair.

- There has been no change in the remuneration rates paid to Board members and the former Chair over the course of our review and since 1992. The most recent Order-in-Council, dated June 11, 2003, re-appointed the former Chair to the Board for a term commencing on July 31, 2003 and expiring on July 31, 2005. This Order-in-Council also appointed and re-appointed other individuals to the Board of WCB and set Board member and former Chair remuneration as follows:

*“The members of the Board of Directors being re-appointed and appointed shall be remunerated at a rate of \$146.00 for each meeting attended by the Director if the duration of the meeting is three and one-half hours or less, or \$253.00 for each meeting attended by the Director if the duration of the meeting exceeds three and one-half hours, together with reimbursement of expenses, including travel expenses, properly incurred in the performance of duties as a member of the Board of Directors.”*

*“The Chairperson being re-appointed shall be remunerated at a rate of \$280.00 for each meeting attended if the duration of the meeting is three and one-half hours or less, or \$540.00 per day for each meeting attended, if the duration of the meeting exceeds three and one-half hours, together with reimbursement of expenses, including travel expenses, properly incurred in the performance of his duties as the Chairperson of the Board of Directors.”*

*“For the purpose of calculating the duration of a meeting, the time spent related to preparation for the meeting shall be deemed to be part of the meeting time.”*

- There is a “Board of Directors Protocol for Remuneration, Business and Travel Expenses” in place at the WCB for Board members and the Chair. The Protocol indicates that expenses not paid directly by WCB for airfare, accommodations and cab fare will be reimbursed upon presentation of receipts.
- Up until June 2001, there was no formal process or policy in place regarding the approval of Board member and Chair per diems and expenses. Although no formal policy or process existed, we noted that the former Chair had approved most of the Board member per diem and expense claims. However, the former Chair’s per diem and expense claims were not approved or reviewed. The lack of an approval process for the former Chair’s per diem and expense claims was a concern raised by the former CEO in March 2001.
- In June 2001, the Board approved a process for the approval of Board member and Chair per diems and expenses. This process requires that Board member per diems and expenses be approved by the Chair, and that the Chair’s per diems and expenses be approved by a member of the Finance Committee. The Chair’s corporate credit card transactions are approved in this manner as well.

**Board Member Per Diems and Expenses**

- Board members fill out a fee reimbursement request form for reimbursement of their per diem amounts earned and for other expenses they may have incurred related to WCB business. The meeting date, the nature of the meeting (Board or Committee meeting), the duration of the meeting (under or over 3.5 hours), the per diem amount earned per meeting, and the total per diems earned are to be indicated on the fee reimbursement request form by the Board member.
- Total per diem payments of \$371,100 were paid to Board members for the period under review. Our review of the per diem payments indicated the transactions were accurate, properly supported and approved, in most instances.
- On average, each Board member was paid meeting per diems of approximately \$7,500 annually.
- Board member expenses for the period examined totaled \$97,000. Of this amount, a total of \$12,700 (13%) was not adequately supported. We consider adequate support to be an itemized receipt from a merchant for the goods or services paid for; a credit card slip on its own is not adequate support.

**Former Chair Per Diems and Expenses**

- The former Chair's per diem and expense claims were documented on a WCB expense report form used for employees, rather than on a fee reimbursement request form used for Board members. The former Chair also had the use of a corporate credit card for travel and other expenses.
- The expense report form does not have a section to record meeting dates and the time required for the meeting, as is required on the fee reimbursement request form.
- We were advised that the former Chair's per diem and expense claim was prepared monthly by his Executive Assistant. Each claim was signed by the former Chair to certify that the claim was a true and correct statement.
- On average, the former Chair was paid per diems of approximately \$90,600 annually. Total per diem payments of \$498,600 were paid to the former Chair during the period under review. During this period, the former Chair's monthly per diem claims only indicated the total amount owing for the total number of days (full and half) being claimed in the month. The specific day or meeting being claimed was not indicated.
- The Chair, as Chair of all Committees, attended all Board and Committee meetings, which were approximately five meetings per month. Our review noted that the former Chair's monthly per diem claim ranged between 12 and 19 days. There was no documentation provided on, or attached to, the former Chair's monthly per diem claim to support the days claimed in excess of the Board or Committee meetings held in the month.



- From January 1, 1999 to June 30, 2004, there were 355 Board and Committee meetings held. Assuming the former Chair attended all the meetings and received a full day per diem for each meeting, this would result in the former Chair earning approximately \$191,700 (355 x \$540) in meeting per diems. However, the former Chair's actual per diem compensation amounted to \$498,600 over this period, which is \$306,900 (\$498,600 - \$191,700) in excess of the compensation paid for time to attend Board and Committee meetings.
- For the period under review, based on the full day per diem rate, the former Chair was paid for an average of 167 days each year. As an average of 63 Board and Committee meetings were held each year, the former Chair charged per diems for approximately 100 days on average each year attending to other WCB business.
- The former Chair indicated that he undertook Chairmanship of WCB under specific instructions from the government of the day (and succeeding government that reappointed him) to play an active role in WCB's governance as his calendar would allow.
- We were advised that support for the former Chair's monthly per diem claims were his daily calendar records which indicated the various meetings (Board, Committee or other meetings) attended by the former Chair each day. We examined the former Chair's daily calendar records for the period under review, and found that in many instances there was insufficient detail provided on the daily calendar to verify that the half or full day claim was appropriate, or inappropriate.
- The former Chair's monthly per diem and expense claims were not approved or reviewed until March 2001. Since that time, the former Chair's per diem and expense claims were approved by a Board member. However, we were advised that no support documentation was provided to the Board member when they approved the former Chair's per diem and expense claim, or his corporate credit card charges, each month. Because of the lack of documentation provided on, or attached to, the former Chair's monthly per diem and expense claim, in our opinion, the approval process added no value.
- We noted that the majority of the former Chair's per diem and expense claims from March 2001 to June 2004 were approved by a member of the Policy Committee, rather than a member of the Finance Committee as required by the approval process adopted in June 2001.
- The former Chair's expenses for the period under review totaled \$60,300. Of this amount, a total of \$17,800 (30%) was not adequately supported by receipts. There were several instances where only credit card slips were provided with the expense reports rather than an itemized receipt from a merchant for the goods or services paid for. Credit card slips do not constitute adequate support, for assessing the appropriateness of an expense for reimbursement.



- Our review of the travel costs incurred by the former Chair on his corporate credit card found no documentation to indicate the purpose of the travel. After discussions with WCB staff, and a review of supporting documentation subsequently prepared for us by WCB staff, we were able to confirm that the former Chair's travel expenses were for WCB business purposes.

## Conclusions

- In our opinion, the former Chair's per diem and expense claims had not been subject to an appropriate approval process. Up until March 2001 there was no approval process in place, and from March 2001 to June 2004 there was no supporting documentation available to the Board member who approved the per diem and expense claims. Further, WCB was not complying, in all instances, with its approval process which requires that a member of the Finance Committee approve the former Chair's per diem and expense claims. A significant number of the former Chair's expenses were not supported by receipts.
- Due to the lack of adequate documentation to support the former Chair's monthly per diem claims, we were unable to verify that the per diem amounts paid to the former Chair were appropriate, or inappropriate, in all instances. The extent of the former Chair's total per diem compensation, for time in excess of meeting time implies a high level of involvement by the former Chair in the day-to-day operational and management activities of the WCB.
- Per diem and expense payments to other Board members are accurate, properly supported and approved, in most instances.

### 5.2.2 Former Chair's Total WCB Compensation

In addition to the total per diems (\$498,600) paid between January 1, 1999 and June 30, 2004 to the former Chair as noted in **Section 5.2.1**, the former Chair also received other compensation from WCB including vacation pay, statutory holiday pay, sick leave entitlements, a car allowance, and an annual payment in lieu of pension benefits.

- For the period under review, the other compensation paid to the former Chair amounted to \$154,300.
- Since 1993, the former Chair has been paid an amount in lieu of pension benefits, based on 12% of his annual compensation.
- *A Memorandum of Understanding for Appointment of Chief Executive Officer* (Memorandum) was entered into between the WCB (under authority of the Policy Committee of the WCB Board) and the former Chair, appointing him to the position of CEO commencing on January 1, 1996. Prior to that, the former Chair had been Acting CEO for the period from May 1995 to January 1996.
- Under the Memorandum dated January 25, 1996, there were provisions for additional compensation beyond the existing Order-in-Council

meeting per diem arrangement. The additional compensation included vacation pay, statutory holiday pay, car allowance and sick leave entitlements.

- The duration of the former Chair’s appointment as CEO continued for almost 3½ years until a new CEO was hired in October 1998.
- We noted that the additional compensation to the former Chair did not end when a new CEO was hired in October 1998. The Memorandum indicated that the additional compensation provisions were to be paid to or credited to the benefit of the former Chair “until the later of” the termination of the former Chair’s appointment as Chief Executive Officer and the termination of his appointment as Chair. As a result, in accordance with the Memorandum, the additional compensation continued until the former Chair’s retirement in February 2005.
- As a result of the additional compensation provided for under the Memorandum and the annual payment in lieu of pension benefits, the former Chair received an amount of \$118,248 from WCB upon his retirement in February 2005. This was made up as follows:
  - Payment in lieu of pension benefits: \$34,278
  - Vacation payout: \$ 5,130
  - Sick leave credits: \$78,840
- Government approval for the vacation and sick leave credits paid upon retirement of the former Chair was provided by the Assistant Deputy Minister, Labour Relations Division of the Treasury Board Secretariat.
- We compared the WCB former Chair’s compensation amounts paid to the Chairs’ of the six largest government enterprises in Manitoba for the calendar years ending December 31, 2003 and 2004. The compensation paid to the former Chair of WCB was significantly higher than five of the other government enterprises and was comparable to only one other government enterprise for the two years.
- Our review of other large government enterprises noted that most other Chairs and Board members are paid a fixed stipend, rather than on a per diem basis.

### Conclusions

- In our opinion, it was not appropriate for WCB to enter into an agreement with the former Chair providing that the additional compensation, while he served as both Chair and CEO, continued after he ceased to serve as the CEO. The Order-in-Council fixing the remuneration to be paid to the former Chair specifically indicated that remuneration was based on a per diem basis for meetings attended. The Order-in-Council did not address the payment of other forms of compensation to the former WCB Chair.
- The compensation to the former Chair of WCB was significantly higher than all but one other government enterprise in Manitoba.

## 6.0 Human Resource Practices

As one objective of our review, we examined human resource practices of the WCB.

We contracted with a firm knowledgeable of, and with experience in, human resources and respectful workplace issues to review concerns regarding inappropriate human resource practices at WCB; and to conduct an organizational review of human resource practices related to senior management positions at WCB.

The review included an analysis of the following:

- Relevant policies regarding respectful workplaces;
- Reasons for turnover at senior management levels since 1999;
- Staffing practices at senior management levels to assess equity and fairness;
- Work environment at senior management levels; and
- Whether WCB was a respectful workplace at senior management levels.

The review assessed human resource practices based on the principles of fair, equitable and respectful human resource standards. WCB has policies regarding a respectful workplace, such as the Harassment Protocol and the Code of Conduct. The definitions of harassment in these policies were used as the basis to assess human resources concerns.

The Harassment Protocol, dated February 16, 1999 states in part:

*“The Workers Compensation Board of Manitoba (WCB) believes that each employee has the right to work in an environment that respects their dignity and well-being...”*

*Harassment is defined as unwelcome and offensive comments, behaviours or actions which offend, abuse, humiliate, demean or cause loss of dignity. In the workplace, the end result of such conduct will ultimately be an intimidating, hostile or offensive working environment...*

*Management has the dual responsibility of not only preventing harassment in the workplace but also responding immediately to stop any activity which undermines the protocol, regardless of whether a complaint has been filed.”*

The Code of Conduct, dated September 21, 1999, states:

*“The Workers Compensation Board expects the highest ethical practices for all of its employees. Our business conduct should exceed the minimum required by law and at all times be able to withstand close public scrutiny.*

*Consistent, courteous and respectful treatment of co-workers and WCB clients is essential to the promotion of a progressive work environment. All staff members are expected to actively promote a work environment that both values and respects the rights and dignity of fellow employees, WCB clients and stakeholders.”*

**OBSERVATIONS**

- Many organizations have a comprehensive Human Resource Policy and Procedures Manual to ensure that all staff are knowledgeable about all acceptable practices and that there is a process in place to address concerns. These policies and procedures would cover all WCB staff and clearly indicate that managers have the responsibility to consistently monitor the application of these policies.
- WCB has policies regarding a respectful workplace, such as the Harassment Protocol and the Code of Conduct, as highlighted above. The Collective Agreement with the Canadian Union of Public Employees also includes provisions regarding a respectful workplace. Although WCB has these policies, they are not part of an overall policy framework applicable to, and understood by, all staff.
- In both of WCB's Harassment Protocol and Investigations Protocol documents, the preamble states that managers are responsible for a harassment free environment, however the procedures emphasize a complaint based approach which puts the onus on an individual complainant. Also, neither document specifies what a manager must do to be proactive in encouraging a respectful workplace.
- Although WCB does have some human resource policies in place for staff, there are no human resource policies in place specifically for the Board of Directors (the Board). However, in interviews with Board members, including the former Chair, interviewees were asked whether their understanding was that the human resource policies for staff also applied to the Board. The consensus was that expectations placed on the staff would also apply to the Board.
- On the basis of the work conducted, the HR consultants reported:
  - That turnover of senior management staff between December 1998 and 2003 inclusive was of a significant number, given the relatively small size of the senior management contingent.
  - That certain incidents of inappropriate behaviour and favoritism occurring in and outside the workplace were reported and corroborated through interviews.
  - That for a number of staff at the senior management ranks, WCB was a hostile work environment, which was never formally acted upon under WCB's harassment protocol or code of conduct policies.
  - That the Board of Directors made its decision to terminate the former CEO prior to fully reviewing the issues brought forward to them, and without consideration given to hiring external expertise to conduct an independent review, given the nature of the issues. The review of the issues as conducted by the Board, subsequent to the termination of the former CEO without cause, was insufficient and lacked follow through.

## Conclusions

- As a result of the Human Resource Consultant's report, we believe that actions are required to enhance WCB's corporate climate and that a planned process needs to be undertaken to ensure that they have a respectful work environment that fosters trust, fairness and open communication and open exchange of ideas.
- By not having a comprehensive Human Resource Policy and Procedures Manual in place to ensure that all staff members and the Board of Directors are knowledgeable about respectful workplace practices and behavior, and by not having guidance for managers on maintaining a harassment free environment, WCB accepted the risk that disrespectful workplace practices and behavior could occur. Human Resource policies are crucial to the health of an organization as they clarify expectations for Board members, managers and staff.

## 7.0 Investment Management

As at December 31, 2004, WCB's invested assets at market value totaled \$785.9 million according to the WCB 2004 Annual Report dated February 28, 2005. **This section of our report covers WCB's private placement investments of \$23.9 million and its Winnipeg-based real estate investments of \$15.7 million.** Of these amounts, 11 of 19 private placements made and located in Manitoba were examined, and 4 of 5 real estate investments made and located in Manitoba were examined. Almost all of WCB's 19 private placements were institutional investments, that is, WCB supplied capital to the managers of a fund to invest on their and other co-investing institutions' behalf.

Some 68.2% of WCB's private placements and 91.1% Manitoba real estate investments were examined in some detail. Our review looked at these two categories as a result of concerns raised with our Office specific to these investment categories.

Notwithstanding that the private placement and the Winnipeg-based real estate investment portfolios together represent only 5.0% of WCB's invested assets at December 31, 2004, the dollar amount of \$39.6 million is significant and requires the application of best practices to ensure that monies are successfully invested. In particular, private placement investing involves accepting a higher level of risk, in exchange for a potentially higher reward.

According to WCB's organization chart as at December 31, 2004, the Investment Department fell under the authority of the Vice President Employer Services and Program Development. WCB did not identify the position of Chief Investment Officer (CIO) on its organization chart or in the Investment Committee minutes. However, the Statement of Investment Policies and Objectives (SIPO), which is discussed in detail later in this section, does refer to the CIO position. The authority and responsibilities of the CIO is detailed under SIPO, and although not specifically stated, it is apparent that the Vice President Employer Services and Program Development had been assigned the CIO responsibilities. In December 2004, this Vice President was seconded to the position of CEO with a local investment fund, subsequently referred to in this report as Partner A.

Therefore, throughout this report we have referred to the Vice President Employer Services and Program Development as the former CIO.

In our report: (a) the “Investment Department” means the CIO, the Director, Investments, and the Administrator, Investments taken individually and as a group; and (b) “private placements” means institutional, venture capital and private equity investments.

## 7.1 REVIEW OF INDIVIDUAL PRIVATE PLACEMENT INVESTMENTS

The observations that follow are based on our review of the 11 private placement investments. Conclusions and recommendations resulting from topic specific observations are covered in other sections of this report.

### **OBSERVATIONS**

- We found that private placement investments were generally being managed by the Investment Department in accordance with the requirements of the Statement of Investment Policies and Objectives (SIPO) document in effect at the time. Although current investment and monitoring files were maintained by the Investment Department in relatively good order, with useful information, not all expected information was contained in the files.
- Certain private placement investments involved inherent conflicts of interest. These conflicts resulted from relationships within Winnipeg’s business community and the willingness of WCB to proceed and invest in spite of these conflicts. Certain investments highlighted conflicting roles with the entities in which WCB invested. Some examples are as follows:
  - In one investment, there were several conflicts of interest involving the main principal of the fund, including his holding of high-level positions and significant ownership in two of the fund’s portfolio companies;
  - The former CIO of WCB served as the Chair of the Investment Committee of an entity which co-invested with WCB; and
  - In one situation, the former Chair of the WCB Investment Committee served as the Chair of the Investment Committee of an entity in which the WCB held investments. The CEO of the entity served as an Advisor to the WCB Investment Committee. WCB and this entity then co-invested in other entities.
- Private placement investments were selected, approved, and booked absent a written investment strategy. As such, investments were not chosen according to a defined or targeted portfolio. Relationships with certain entities and individuals appear to have been the driving forces behind building WCB’s portfolio of private placements.
- “Investment Committee Agendas” (a WCB standard format used to summarize investment information for the Investment Committee)

prepared by the Investment Department for presentation to the Investment Committee for approval purposes were inadequate. Agendas were too brief, contained too much in the way of material provided by the principals of the entity seeking capital from WCB, and contained too little evidence of original work performed, particularly regarding due diligence work, to support the decision to invest. In one investment, although the Agenda indicated that the principals *“are three individuals who collectively have a broad range of skills, experience, contacts and a track record in lending, fund management, venture capital investment and management, business assessment and capital raising necessary for a successful private debt/equity fund of this nature”*, there was no documentation indicating how this statement was supported and verified.

- Investment Department reporting to the Investment Committee was inadequate regarding the status, progress and performance of individual private placements and for the portfolio taken as a whole, in terms of documented material such as thorough reports. Although reports were not complete, accurate, nor timely, the Investment Committee did not request improvement.
- On a quarterly basis, an external consultant prepared an investment performance and manager review package that provided certain performance and other information regarding all of WCB’s invested assets. These overall reviews, while interesting, were not of much use in assessing the individual performance and status of those investments, because of the nature of WCB’s private placement and Manitoba-based real estate investment opposite its more liquid assets.
- The Investment Department did not always follow-up with private placement investments that were not complying with their reporting requirements. There was no evidence that these reporting deficiencies were waived by the Investment Department, and there was no evidence of action and analysis to correct the deficiencies in the monitoring files or under request of the Investment Committee.
- The Investment Committee did not follow-up on private placement investments as a matter of routine, including those that the Investment Committee knew were undergoing difficulties. Investment Committee minutes were silent for long periods of time in terms of mentioning many of the private placement investments.

## Conclusion

- Once investments were made by WCB, there was a need for regular status reporting to the Investment Committee and follow-up of any reporting deficiencies or difficulties being experienced with an investment.



## 7.2 REVIEW OF STATEMENT OF INVESTMENT POLICIES AND OBJECTIVES (“SIPO”)

### OBSERVATIONS

#### No Documented Private Placement Investment Strategy at WCB

- No coherent vision, strategic direction and investment strategy was presented to the Investment Committee regarding the private placements investment program. This was a responsibility of the former CIO.

#### SIPO Document in Place

- WCB produced a SIPO document (**Appendix A**). The most recent version is dated January 2005. The SIPO governs investment policies and objectives for all of WCB’s invested assets including private placements and real estate.
- Earlier versions of SIPO – February 2004, March 2002, and April 2000 (amended) – indicate the steady and continuing development and improvement of WCB’s investment philosophy, policies, objectives, and certain processes and procedures over several years.
- Since 2002, the SIPO document was prepared by an external consultant based on input from the Investment Committee and the Investment Department.

#### SIPO Content Incomplete

- Our review of Appendix II of the SIPO document entitled, *Underwriting Criteria for Venture Capital*, found it to be inadequate for institutional investing decision-making because:
  - “Venture capital investments” were defined as including private equity and institutionally made investments (which were universally referred to as “private placements” in various WCB files, documents and statements);
  - There was no distinction made between venture capital and private equity (including where an investment was to be made directly by WCB or indirectly by funding another fund as an institutional investor);
  - There was no industry standard list of investment selection criteria for institutional investing to guide the Investment Department and Committee;
  - There was no guidance regarding what due diligence work to perform, and how to perform it;
  - There were no protocols (when, why, how) for relying on another investor’s due diligence;
  - There was no basic requirement for the principals of a fund seeking capital from WCB to have proven track records of successful venture



capital and/or private equity investing over a significant period of time, including the demonstrated ability to: (1) access quality deal flow; (2) add value to portfolio companies; and (3) maximize exit values; and

- The statement that WCB should “expect a compounded annual rate of return in excess of 20% for this type of investment” made no distinction between the reasonable return expectations of direct private placement investments, institutional investments, and for the private placements portfolio taken as a whole.

### **No Documented Processes and Procedures to Guide the Management of Private Placement Investments**

- A suitable investment regimen for the Investment Department was not established, in terms of ensuring that appropriate investment processes and procedures were in place to act as a guideline for “how” private placement investments were to be handled. This was the responsibility of the former CIO. As a result, processes and procedures were largely informal and were inadequate particularly regarding how private placement investments were to be:
  - Screened, selected, analyzed and assessed, including against specific investment criteria, prior to deciding to perform extensive due diligence;
  - Vetted in terms of performing extensive due diligence work. Presently, there is no due diligence checklist in use;
  - Written up and otherwise supported for approval purposes;
  - Booked and documented (boilerplate terms and conditions and formal legal agreements);
  - Managed and monitored including the maintenance of current monitoring files and internal reporting requirements (minimum standard documentation and in what format, communication media, and the specific frequency of reporting);
  - Valued, how often, and under what methodologies;
  - Remediated in the case of both routine and non-routine problems with an investment being identified; and
  - Handled vis-à-vis lines of responsibility and authority within the Investment Department for various matters.

### **WCB Return Expectations of Venture Capital and Private Equity Investments Vague**

- The Investment Department was vague regarding the return potential of institutional venture capital and private equity investments, and how this might affect WCB’s investment strategy and return expectations.
- “The fourth belief” in the “Statement of Investment Beliefs” generally indicated that WCB believed in investing in private placement and real estate transactions in Manitoba provided that comparable returns to

comparable investments in other jurisdictions were anticipated. However, the comparability to investments in other jurisdictions and of anticipated returns was not supported in documentation. Members of the Investment Committee were of differing recollections regarding whether or not private placements were made because of the fourth belief.

#### **SIPO Conflict of Interest Guidelines Unclear**

- Although there were conflict of interest guidelines in the SIPO document, the disclosure requirement was not clear in terms of the definition of what may constitute a “material conflict of interest”.
- The former Chair was responsible for administering conflicts of interest and for determining what was appropriate under the circumstances. The SIPO was deficient regarding administration, including documentation, communication to members of the Investment Committee, and resolution of conflict of interest situations either directly or indirectly involving the former Chair.

#### **Conclusions**

- The existence of a SIPO document demonstrated the effort of WCB to codify certain elements of what it was trying to do with its Manitoba-based private placement and real estate investments. However, there exist opportunities for improvement in the areas of clarifying rate of return expectations, conflict of interest, and investment criteria for direct private placements that will assist in managing risks associated with these types of investments.
- Since the private placements investment strategy was not documented, the risk existed that WCB’s specific and general investment objectives in SIPO would not be achieved. It is difficult to execute, or assess success of, an investment strategy that is not documented.
- Due to the undocumented and largely informal investment processes and procedures that guided the Investment Department, accurate, timely and complete information regarding private placement investments was not reported to the Investment Committee, increasing the risk that poor investment decisions would be made.

### **7.3 PORTFOLIO CONSTRUCTION**

#### **OBSERVATIONS**

- As noted in **Section 7.2**, WCB’s private placement portfolio was constructed without the benefit of a comprehensive and documented investment strategy for the Investment Committee and Department to follow.
- Out of 19 private placement investments as at December 31, 2004:
  - 7 were for direct investment in venture capital transactions (various sectors);

- 2 were for investment in private equity transactions;
  - 7 were a mixture of both venture capital and private equity; and
  - 3 other investments were more difficult to categorize and are best considered as one-off; and transactions, including one secured real estate investment.
- Many of WCB's private placement investments involved the same Winnipeg-based co-investors and often lacked co-investment capital and expertise from outside of the Province of Manitoba. Co investors were usually:
    - Other Winnipeg-based financial institutions;
    - Winnipeg-based investment funds;
    - Agencies of the Province of Manitoba; and
    - Individual investors, including the principals of the private placement entities.
  - Up until July 2004, the last time WCB made an investment in a fund located outside of Manitoba was in 1995. In July 2004, WCB committed \$10 million to a conventional institutional investment fund, for investment in and outside of Manitoba. One Investment Committee member and the Advisor expressed concern that participating in this transaction may take money away from Manitoba-based funds. Their concern illustrates that they might have been inwardly focused at the expense of potential returns that could be earned from investment outside of Manitoba.

## Conclusion

- Opportunities to improve WCB's private placement investment performance may have been sacrificed by continuing to only invest in funds that made investments in Manitoba. This practice may have conflicted with the Committee's responsibility to "generate the highest possible return" with WCB's assets. Broader investing provides a number of benefits such as:
  - The opportunity to learn from the involvement with the outside-of-Manitoba fund being supported;
  - General institutional investing learning opportunities from associating with the other financial institutions/limited partners involved;
  - Exposure to state-of-the-art techniques in assessing the quality of an institutional investment opportunity including due diligence approaches;
  - Exposure to live examples of up-to-date terms and conditions that make up the legal documents papering a transaction; and

- The opportunity to associate with those who may be helpful in opening the door for WCB to be a limited partner in some of Canada's top quartile funds.

## 7.4 INVESTMENT APPROVALS

### **OBSERVATIONS**

- Decisions and approvals for private placement investment opportunities were made as follows:
  - Investment opportunities were received by WCB from various sources – other financial institutions, co-investors, the principals of entities that received funds from WCB in the past, and directly from new capital seekers;
  - Requests for capital often arrived directly to WCB's Chair, the former CIO and the Director, Investments;
  - After an initial review, requests for capital that were not immediately declined, and that were considered to be worthy of further consideration, were referred to the Director, Investments and Administrator, Investments, for further analysis and work;
  - Prior to bringing an investment opportunity before the Investment Committee, the principals of the entity seeking capital were normally invited to meet with the WCB Chair, the CEO, and the former CIO;
  - Investment opportunities that were to be presented to the Investment Committee were written up by the Investment Department in a WCB standard format "Investment Committee Agenda" for presentation to the Committee; and
  - An investment may have been included as an Agenda item several times before final approval by Investment Committee.
- There was no evidence that any investment opportunities brought before the Investment Committee were declined outright. Many were delayed pending either an improvement in the transaction, or further work being completed before final approval was granted.
- Presentations to the Investment Committee were normally attended by the former CIO, the CFO, the Director, Investments, and Advisors to the Investment Committee. Often, the seekers of capital were invited to attend and present the case for investment in person.
- Information used by the Investment Department to support investment decisions for the Committee was quite brief – normally 3-4 pages, plus attachments. The investment opportunity was outlined together with a short section on the rationale in support of the recommendation.
- We did not find that information prepared by the Investment Department for the purpose of gaining approval for transacting private placements was fulsome enough to be stand-alone documents containing

all of the evidence needed to support the investment recommendation. This was the responsibility of the former CIO. Material provided did not usually contain the following information, some of which may have been delivered verbally to the Investment Committee:

- The type and nature of the investment – venture capital, private equity, institutional, passive, direct active co-investment, etc.;
- A description of the business, financial, and exit risks associated with the proposed investment and mitigating factors, if any;
- A description and evidence of the due diligence work performed by the Investment Department, such as:
  - Appropriate financial analyses;
  - The frame of reference and other considerations that support the risk assessment (high/low) and return expectations of the investment;
  - Work done to review the character (integrity, reliability, professionalism) of the principals of the fund;
  - Work done to review the compatibility of the principals with each other as partners;
  - Work done to verify the investment track records of the principals;
  - Work done in reviewing the viability of the investment strategy of the fund; and
  - Work done to be sure that the information provided to WCB by the principals seeking the capital is complete and accurate;
- Due diligence work yet to be completed;
- Due diligence work that will not be done and why appropriate in the circumstances;
- A description of work performed by and the findings of outside advisors if experts were employed by WCB to help assess the investment opportunity;
- A description of co-investors, if any;
- A description regarding how a proposed investment would fit with an investment strategy;
- A description of investment management and monitoring and internal reporting plans for the investment;
- Confirmation that the proposed private placement investment was consistent with the SIPO document;
- The source of the investment opportunity, and what finders fees or other compensation may be paid and to what third party for bringing the deal to WCB; and

- Clear disclosure or declaration of prior and current relationships or connections of the investment entity or its principals, if any, with:
  - WCB or any of its officers, employees or other investments;
  - Other financial institutions whether related to the transaction under review or not; and
  - The Province of Manitoba.

## **Conclusion**

- In our opinion, the information provided to the Investment Committee as a basis for investment approval was insufficient to determine whether or not an investment opportunity should be approved or declined. Accordingly, the risk of loss on any given investment was increased.

## **7.5 INVESTMENT MANAGEMENT, MONITORING AND INTERNAL REPORTING**

### ***OBSERVATIONS***

- After approval, the Director, Investments and the Administrator, Investments were responsible for managing, monitoring and reporting on the progress, status, and performance of the investments.
- The Investment Department maintained investment management and monitoring files. However, WCB did not have a policy or a checklist outlining what was required to be kept in its investment monitoring files. Files of each private placement investment were not consistent in terms of content, and varied depending upon the nature and documentary output of each individual investment. As a result, all of the information that should have been in the current monitoring files may not have been there.
- After an investment was funded, there was no evidence that the Investment Committee was notified regarding that fact, such as by way of a "closing memo." A closing memo, prepared shortly after an investment is funded, could include the following information:
  - Brief details regarding the investment;
  - That the investment approved was the one that was booked with regard to terms and conditions and other material matters;
  - Comments regarding co-investing limited partners;
  - Conflict of interest situations, if any, and how they were handled;
  - Outstanding loose ends that require follow-up and resolution;
  - Lessons learned;
  - Significant exceptions to the SIPO document and related addendums; and

- Any other information that appears to be appropriate and that would appear to have future value by being written down shortly after closing.
- After private placement investments were booked, the Investment Committee was not routinely provided with sufficient information to determine the progress and status of each investment in the private placements portfolio. This was the responsibility of the former CIO. In addition, there is no evidence that the Investment Committee requested this information from the Investment Department.
- It was not until April 2004 that the Investment Committee conducted a review of 11 funds in the institutional private placements investment portfolio. However, there is an absence of evidence that anything more than basic information about what the investments were, rather than the performance and status of each individual investment was presented to the Committee. Information that may have been reported verbally was not detailed in the minutes of the meeting.
- In May 2004, the Investment Department revamped their approach, preparing a “Summary of Private Placement Investments” to provide more information. For example, the discounted cash flow yield and exit strategy (in a few, words such as “exercise” and “private sale”) were added. However, whether or not the investment was or was not performing in accordance with expectations was left to interpretation, since a clear articulation regarding the performance and status of each investment was neither provided nor recorded.
- The Committee did not receive information that would have helped them to better, assess and question the status, progress and performance of each individual private placement investment. They did not receive the following information:
  - Investments done by the fund and a brief assessment of how major ones were performing, including problems and disputes identified and remedial action being proposed and undertaken and by whom;
  - Realized, unrealized and total return on their investment in the fund, and a comment regarding whether or not the investment is and is still expected to provide an ultimate return in accordance with expectations;
  - The amount of capital remaining in the fund to invest in new transactions and the amount designated for follow-on investments in the fund’s portfolio companies;
  - Significant changes in the fund’s investment strategy, if any, and its possible effects;
  - Capitalization changes since the initial funding and a list of co-investors in the fund;
  - The anticipated return on investment when the fund is finally exited;

- The names of the fund's principals, an assessment of their conduct and performance, and the status of their compensation scheme;
  - Reporting deficiencies (reporting to the limited partners by the fund), if any;
  - Lessons learned from the investment;
  - Loose ends and other to dos; and
  - Conclusion and recommendations, if any.
- Although implied by SIPO's Appendix II, neither the Investment Department nor the Finance Department computed an internal rate of return (IRR) on its private placement investments either individually or on the portfolio taken as a whole. Instead, beginning in 2002, on a non-routine basis, an approximation of IRR was computed on a discounted cash flow (DCF) yield basis.
  - Neither the Investment Department nor the Finance Department calculated, for long-term performance measurement purposes, realized and unrealized gains and losses on individual private placement investments and on the portfolio taken as a whole. In fact, the overall performance of private placement investments since 1991 was not known in terms of either dollars or return on investment percentage due to the absence of information.
  - The next comprehensive review of the institutional private placements investments portfolio by the Investment Committee did not occur until July 2005. This was not in accordance with the SIPO requirement for the Investment Committee to meet "at least quarterly" to review the progress and status of private placement investments.
  - Prior to December 31, 2004, the carrying values of private placements were generally at cost (less capital returned) with certain exceptions including investments that could be marked-to-market. Subsequent to December 2004, WCB changed from cost to fair value reporting in accordance with revised accounting guidelines.
  - The carrying value of one direct private placement investment was \$2.0 million as at December 31, 2004 despite WCB not yet having funded any part of a subordinated credit facility for a borrower that began operations earlier that year. This carrying value was based on the deemed value of WCB's equity position received for providing the facility, and was supported by the price of the units issued to other limited partners and WCB's pro rata share, thereof. However, a conventional valuation report in support of the \$2.0 million deemed value was not available for review. It should be noted that the WCB had an offsetting liability on the balance sheet of \$1.7 million represented as unearned revenue.



## Conclusions

- Because much of the due diligence, closing, performance and status information regarding each private placement investment remained undocumented, the risk existed that important information regarding these investments would be lost if the Director, Investment and/or Administrator, Investments were to cease working for the WCB.
- The Investment Committee did not meet “at least quarterly” to review the progress and status of private placement investments in accordance with their responsibilities as set forth in the SIPO document. Once an investment was booked, and unless there was a formal need to bring an investment before the Investment Committee again, such as the opportunity to invest more of WCB’s funds, internal reporting by the Investment Department to the Investment Committee was largely on an exception and/or request basis only.
- The \$2.0 million deemed carrying value of one private placement investment was not supported by a conventional valuation based on the operating performance of the investment, and therefore is uncertain.

## 7.6 STAFFING ADEQUACY

### *OBSERVATIONS*

- The former CIO during the period under review did not have hands-on investing experience in either private placements or real estate, though he had experience as a Board member and Chair of the Investment Committee of a public sector pension fund.
- The current CIO (since December 2004), who is also the CFO of the WCB, does not have a private placements investment background.
- The Director, Investments has a variety of investment experience (private placements of debt, public bonds desk, structured finance) gained with another Manitoba-based financial institution prior to coming to WCB in 1998. She replaced the Real Estate Consultant in the role of being responsible for managing and monitoring private placement investments in 2001.
- There was no written job description for the Director, Investments position; however a position description for the Administrator, Investments is in place.
- Besides the private placement and real estate investment portfolios, the Director and Administrator, Investments also administered the other asset managers engaged by WCB.
- No one in the Investment Department was a member of either the Canadian Venture Capital Association (CVCA) or the Institutional Limited Partners Association (ILPA), nor did they attend annual conferences. The CVCA is the association for the Canadian venture capital and private equity industry. The ILPA is the industry association for institutional investors. However, the WCB is a member of the Pension Investment

Association of Canada (PIAC) which they indicated to us addresses many of the issues impacting the performance of diversified investment portfolios.

### Conclusion

- The WCB did not take steps to address the need for more in-depth experience in private placement investments. In particular, the former CIO did not encourage Investment Department staff to belong to the CVCA and/or the ILPA and to attend their annual conferences and training seminars.

## 7.7 INVESTMENT COMMITTEE GOVERNANCE

### OBSERVATIONS

- Section 95 of The Act mandates the establishment of an Investment Committee *“to regularly review the investments in which the accident fund is invested and provide directions in writing as to the investments in which monies in the Accident Fund and available from time to time for investment shall be invested”*. The composition of the Investment Committee is mandated to be three members: the Chair of the WCB Board of Directors (or a person designated by the Chair) who serves as the Committee’s Chair; the province’s Deputy Minister of Finance, and an Order-in-Council appointed employer representative.
- According to a press release dated December 11, 2003, the Investment Committee *“operates independently from Government and the WCB Board of Directors”*, and that the *“Investment Committee searches out investment opportunities with favourable returns and limited risk, and follows a rigorous due diligence process to ensure that all investments are sound and solid business opportunities”*. However, as authorized by The Act, the former Chair of the Investment Committee was also the former Chair of the Board. Although the Committee did not report directly to the Board, having the same Chair, created a lack of independence.
- For the period reviewed, only one Investment Committee member, who has served since March 2002, had significant experience and expertise in the investment industry.
- For the period reviewed, the Investment Committee retained two non-voting *“Advisors”* who attended all meetings. Investment Committee Advisors were chosen by the former Chair.
- The Investment Committee normally met once a month. Meeting agendas were set by the former Chair after consultation with Committee members and the Investment Department and included matters suggested for inclusion from previous meetings. According to Committee members, the meetings were conducted by the former Chair largely on a consensus basis. That is, matters brought before the Committee were not approved unless, and until, all members were in agreement. Ex-officio members of the Committee – the CEO, CFO, CIO,

and Director, Investments – while not having a vote, were often treated as having an equal voice on most matters.

- There was no evidence that an assessment of the performance of the Investment Committee was ever performed.
- The small size of the Investment Committee at three members can potentially present difficulties for the organization. For example, if a member was absent or if a conflict of interest situation arose, the Investment Committee became too small to be effective in terms of providing governance and guidance to the Investment Department.

## Conclusion

- The institutional private placement investment business is very complex, dynamic and requires knowledgeable people with significant governance and investment experience in order to be effective in an oversight and guidance role. In our opinion, more expertise is needed on the Investment Committee in order to properly oversee WCB's private placement investment program.

## 7.8 REVIEW OF WCB WINNIPEG-BASED REAL ESTATE INVESTMENTS

WCB began investing in real estate in 1989 when minority positions in 10 properties were acquired from the Alberta Government Teachers Fund. Since that time, significant changes have occurred in the real estate portfolio.

The total portfolio grew in size to \$73.9 million market value as at December 31, 2004, representing 24 individual properties, with another \$6.0 million in future commitments yet to be funded as at that date. Of this amount \$15.7 million was invested directly in Manitoba real estate.

Other properties were located across Canada, with 94% in industrial, office and retail properties in terms of type.

Properties were managed by seven asset managers. The largest of the asset managers was responsible for 63.6% of the market value of the assets managed as at December 31, 2004. The next largest asset manager managed 8.8% of the portfolio. A real estate consultant (R/E Consultant) managed the seven asset managers for WCB pursuant to a Portfolio Management Agreement (see Appendix C).

WCB held its ownership interest positions in individual properties both directly and indirectly. Direct holdings were through WCB Realty Limited, a wholly-owned subsidiary of WCB. As at December 31, 2004, eight properties were directly held.

Indirect real estate interests were held by-way-of a privately held real estate company owned by 37 of Canada's largest institutional investors. Specially created participating bonds flow property income to investors like WCB, allowing participants to trade, and increase or decrease their position in a property through the sale or purchase of the participating bond via a well-developed secondary market for the bonds.

### 7.8.1 Review of Winnipeg-Based Real Estate Investments

#### OBSERVATIONS

- Of the five Winnipeg real estate investments that were on the books as at December 31, 2004, four were reviewed in detail. These four investments represent \$14.3 million, or 91.1% of the total local real estate portfolio of \$15.7 million.
- Of these four, three were Winnipeg-based real estate investments and the other was a real estate fund, henceforth referred to as ABC Fund.

#### Three Winnipeg-based Real Estate Investments

- The R/E Consultant's real estate investment management and monitoring files contained information about the three investments accumulated during the period leading up to their closings, as well as the normal information prepared on or about the times of the closings of the purchase of the properties.
- The Investment Department's investment management and monitoring files contained all of the information one could reasonably expect to find regarding these real estate investments.

#### Review of ABC Fund

- ABC Fund was an investment (with a \$10 million commitment from WCB) that was dedicated to making real estate investments related to revitalization, redevelopment and/or development of the downtown area of Winnipeg. As at December 31, 2004, WCB had advanced \$2.3 million to ABC Fund in support of the purchase of four parking lots and two office buildings.
- Following a lengthy period of working to structure an investment that the Investment Committee was prepared to approve, the ABC Fund investment was booked on July 20, 2004. In accordance with the Initial Partnership Agreement, an Amended and Restated Limited Partnership Agreement, a Shareholders' Agreement, a Property Management Agreement and a number of other related documents, WCB advanced an amount of \$250,000 representing their initial subscription payment for 10,000 Class A Units of the Limited Partnership.
- WCB's total commitment of \$10 million represented 66.7% of the total funds committed by the other Initial Limited Partners – Partner A (3,000 Class A Units for \$3 million, representing 20%) and Partner B (2,000 Class A Units for \$2 million, representing 13.3%). In addition, and pursuant to a Co-Ownership Agreement, Asset Management Agreement and other documents also dated July 20, 2004, a Manitoba-based pension fund (Partner C) agreed to commit and fund an amount of \$10 million on a basis that allowed that institution to hold undivided interests (40%) in each of the properties that ABC Fund purchased. Further, Partner C had the right to review and approve all property purchases that it participated in, and also had the right not to participate in any property brought to them by Partner B.

- Partner C did not use the same investment structure as WCB for various reasons including that, under pension legislation at the time, ABC Fund was not a qualified limited partnership.
- The General Partner of the Limited Partnership was owned by Partner A (65%) and Partner B (35%). Annual management fees were 1.5% of committed capital for the initial \$25 million.
- From March 2002, when WCB's Investment Committee was first introduced to the ABC Fund investment opportunity concept, there was a great deal of attention and controversy regarding WCB participating in the investment.
- In May 2002, the former CIO of the WCB, in his role as Chair of Partner C and Chair of Partner C's Investment Committee, raised the issue of Partner C investing in ABC Fund at an Investment Committee meeting of Partner C. He suggested that consideration be given to local investing, and that it would be beneficial for the Investment Committee to receive a presentation on potential investment in ABC Fund. This occurred on June 10, 2002.
- On June 14, 2003, at a meeting at WCB, with the Chair of Partner C (who was CIO of WCB at the time) present, it was indicated to the former CEO of Partner C, that the WCB had already committed \$10 million. However, the WCB Investment Committee had not yet approved this commitment. The CEO of Partner A (who was also the WCB Investment Committee Advisor) was present and was promoting the investment in ABC Fund to Partner C.
- A review of documentation regarding ABC Fund, covering a period of several years indicated that there were many issues, objections and concerns from virtually every party involved. The main points of contention prior to, during, and subsequent to the booking of the investment by WCB were documented as follows:
  - On June 20, 2003, an internal WCB memo from the Director, Investments to the former Chair of the Investment Committee, the former CIO, and the CEO highlighted concerns of: lack of other institutional investors; the vending in of a property owned by Partner B, rather than funding their participation in cash; conflicts of interest amongst certain of the parties; and the need for WCB to perform its own due diligence on the investment.
  - On June 20, 2003, an Investment Committee member wrote to the former CIO and the CEO (forwarded to the Chair of the Investment Committee by the CEO) stating the following concerns: "feeling rushed" with the need to take more time to make an investment decision; the need for input from WCB's R/E Consultant; fees; the proposed duration of ABC Fund; valuation issues; conflicts of interest; and the need for a more complete business plan for the ABC Fund.

- The June 23, 2003 minutes of the Investment Committee indicated that the R/E Consultant attended, and that he had been asked for a confidential memo outlining his problems/concerns with the ABC Fund offering. The Investment Committee minutes also stated that, "... *subject to terms, conditions, and clarifications, they are interested in proceeding to the next stage although a Committee member has some serious concerns*". It was also stated that, "...*at least one other institutional investor, aside from [Partner A] and [Partner B], will need to invest an amount equal to or greater than any investment by the WCB*".
- Subsequent to the Investment Committee meeting, in a memo to the Chair of the Investment Committee, the CEO, the former CIO and the Director, Investments, the R/E Consultant noted the following concerns: structure of the ABC investment; development activity issues including conflicts of interest; the use of mortgage leverage by ABC; the level of general partner fees; and the nature and limitations of ABC's advisory committee.
- In July 2003, a meeting was held with representatives from ABC Fund (Partner A and Partner B), WCB's Investment Department and the R/E Consultant. Outstanding issues with regard to the proposed investment were discussed including the partnership structure, leverage, development activity, and fees.
- On September 17, 2003, the ABC Fund deal was discussed at the Investment Committee. According to the Agenda, concerns noted with the offering documents had been resolved between WCB's Investment Department, the R/E Consultant and representatives of ABC Fund (Partner A and Partner B). As a result, the investment was approved in principle conditional upon satisfactory documentation, and with at least one other institutional investor investing an amount equal to or greater than WCB. The WCB Chairperson and the Investment Committee's Advisor (Partner A) excused themselves from this meeting due to their inherent conflicts of interest with regard to the ABC Fund transaction.
- At the November 17, 2003 meeting of the Investment Committee of Partner C, the Chair (also the CIO of WCB at the time) informed Partner C's Investment Committee that the ABC Fund had been formed. On December 15, 2003, ABC Fund made a presentation to the Investment Committee of Partner C and based on this, Partner C's Investment Committee passed the following resolution: "*That the Committee approve, in principle, a commitment of \$10 million to [ABC Fund]...*". It was noted that "*appropriate due diligence is still required respecting this investment*".
- On December 18, 2003, the Investment Committee Advisor (Partner A) "*advised the Committee [WCB Investment Committee] that Partner C had approved a \$10 million investment in ABC Fund, and therefore ABC Fund would be moving ahead in the new year. The initial closing, including WCB's commitment of \$10 million, would be for \$25 million by the end of January 2004*".

- In late January 2004, the former CEO of Partner C was advised by the Chair (the CIO of WCB at the time) and Vice-Chair of the Board of Partner C that his employment was terminated. No information was provided, other than noting his contract would not be renewed. In September 2004, the former CEO provided a letter to the Minister of Education, copying other individuals highlighting his concerns regarding his dismissal. The letter specifically detailed his concerns regarding the ABC Fund transaction and the conflicts inherent in Partner C entering into this transaction. His letter received insufficient response. On September 30, 2004, an extract of his letter dealing with the ABC Fund was sent by the former CIO of the WCB to the CEO of Partner A (the Investment Committee Advisor to the WCB).
- In February 2004, a report on ABC Fund, understood to have been commissioned by the former CEO of Partner C, written by a Winnipeg-based investment management company, was received by the Investment Department of WCB. The investment management company's "major issues" included a number of the same items previously noted by WCB dealing with issues of: staffing; fund objective; projections; investment in kind; conflict of interest; partnership agreement; term of the fund; target market; and property management. The investment management company's report ended with the comment that "*an investor should only consider this fund if it has a fundamental desire to assist in the revitalization of downtown Winnipeg*". Their recommendation was that Partner C should not participate unless there were significant amendments to the deal.
- The investment management company's report was never referenced in the minutes of any WCB Investment Committee meeting, and it is not known if Investment Committee members ever received a copy of the report.
- In March 2004, WCB's former CIO (and also Chair of Partner C), told the Investment Committee of WCB that "*due diligence with regard to [ABC Fund] is moving along*". Investment Committee minutes for the balance of 2004 did not indicate any further discussion of the ABC Fund investment.
- This announcement was coincidental with the departure of the former CEO of Partner C in March 2004 who had not supported the ABC Fund transaction.
- WCB booked its investment in ABC Fund in July 2004. Partner C concluded its investment in ABC Fund in July 2004.
- In November 2004, the R/E Consultant wrote a memo addressed to the Chair of Partner C (WCB's CIO at the time), which was, in many respects, a "closing memo" that provided an update on Partner C's ABC Fund investment. The memo noted the remedies taken opposite many of the issues noted in the February 2004 investment management company's report.



- As at December 31, 2004, the carrying value of the ABC investment on WCB's books was the same as its cost - \$2.3 million.
- In May 2005, the R/E Consultant attended at the WCB Investment Committee to discuss recent developments with the ABC Fund investment including issues with Partner A which was not living up to its various responsibilities and agreements with regard to the investment.
- In June 2005, ABC Fund's management company was put on notice by WCB that it was in default of its obligations under the Amended and Restated Limited Partnership Agreement.

### Conclusions

- The ABC Fund investment illustrates why conflict of interest situations, either in appearance, or in fact, should be avoided. Conflicting roles and concurrent relationships that made the ABC Fund investment problematic from a conflict of interest perspective included:
  - WCB's former Chair/former Chair of the Investment Committee was also Chair of the Investment Committee of Partner A;
  - WCB's former CIO also chaired the Board and the Investment Committee of Partner C;
  - The WCB Investment Committee's Advisor was the CEO of Partner A and the promoter of the ABC Fund;
  - Partner A, an investor in ABC Fund, owned 65% of the management company, and 50% of the ABC Fund development corporation (which was proposed to renovate, develop and redevelop the ABC Fund properties for a fee); and
  - Partner B, an investor in ABC Fund, contributed an asset that it owned to the initial transaction rather than cash, owned 35% of the management company, and 50% of the development corporation.
- By actively pursuing a transaction such as ABC Fund amidst conflicting roles, concurrent relationships, and considerable concerns leading up to the transaction's finalization, WCB placed their public reputation, and monies of the WCB, at risk.
- In spite of WCB's former Chair and the Investment Committee Advisor leaving the room in order to avoid a conflict of interest when ABC Fund was being discussed by the Investment Committee, we believe that their advocacy in favour of the ABC Fund investment was an influence on the Committee's ongoing deliberations.
- Given the concerns expressed by so many, June 2003 was too soon in the development of the ABC Fund investment for the WCB Investment Committee to be asked to approve the notion of proceeding to "the next stage".



- It is unclear why WCB structured the ABC Fund investment with the Partner A and Partner B as the owners of the management company. It begs the question as to why WCB did not simply sponsor the R/E Consultant as the property manager along the lines of how the investment was initially contemplated in December 2001. By the time the investment was booked in July 2004, all of the changes needed in order to be able to accommodate the ABC Fund investment in accordance with the ABC Fund management company structure had cost WCB time, energy and money.
- Conflicts of interest made for difficulties for Investment Department staff, and could have led to poor decision-making. It should not have been left to the Director, Investments to be moved to remind her superiors, in a June 20, 2003 memo that, *“it is important for WCB to do independent due diligence of the project, as our interests and the interests of the promoters are not entirely the same”*.
- The three Winnipeg-based real estate investments were being managed appropriately, including regarding the maintenance of files, in accordance with R/E Consultant’s Agreement.

## 7.8.2 Real Estate (R/E) Consultant’s Portfolio Management

### OBSERVATIONS

- The R/E Consultant provided outsourced experience and expertise. His qualifications to be WCB’s outsourced real estate portfolio manager and an asset manager are considerable. Based on comments made by members of both the Investment Committee and Department, the R/E Consultant was respected for his real estate experience and expertise and for other work he did for WCB.
- The R/E Consultant formally reported to WCB as per a Portfolio Management Agreement (Agreement), and was in regular contact with the Investment Department and the former CIO. He was the asset manager for three of WCB’s real estate investments in Winnipeg: a downtown office building; an industrial building leased to a single tenant; and a retail strip mall.
- Real estate investment decisions and approvals were made as follows:
  - Investment opportunities were fielded directly by the R/E Consultant and from the other asset managers;
  - Review of investment proposals was the responsibility of the R/E Consultant using the Investment Department as a resource;
  - Presentations for approval purposes were made by the R/E Consultant together with the Investment Department using a version of the “Agenda” format;
  - The CEO, former CIO and Director, Investments reviewed all real estate investment proposals for approval purposes. For investments up to \$2 million, two of the three determined WCB’s participation.

For investments above \$2 million, all three made the investment decision;

- For investments above \$5 million or of an unusual nature, Investment Committee approval had to be obtained before participation; and
  - All new real estate activity had to be reported to the Investment Committee.
- Once booked, managing and monitoring was the responsibility of the R/E Consultant using the Investment Department as a resource.
  - The largest “sub-asset manager” managed by the R/E Consultant prepared, on a quarterly basis, a detailed review of the 12 real estate assets it manages for WCB under the sub-advisor agreement. The report for the quarter ending December 31, 2004 covered \$42.4 million or approximately 53.5% of the WCB real estate portfolio in terms of funded market value. Other sub-asset managers provide individual reports regarding the properties they manage on a quarterly basis.
  - The R/E Consultant reviewed reports received from the sub-asset managers for reasonableness, and to identify problems for further follow-up, including any remedial action that may have been required.
  - The R/E Consultant prepared an annual report which was presented to the Investment Committee each year. The Consultant’s annual reports were well written and represented a good summary of the status of WCB’s real estate portfolio. The Consultant’s annual reports, however, lacked detail regarding the Manitoba-based properties. This was in contrast to the great amount of detail provided in the quarterly reports prepared by the sub-asset managers.
  - The R/E Consultant did not prepare quarterly reports addressing the performance of the real estate portfolio as required under his Agreement.
  - The R/E Consultant did not prepare closing reports on the properties that are added to the WCB real estate portfolio as required under his Agreement.
  - The R/E Consultant maintained Manitoba-based real estate files which contained much of the information one would reasonably expect to find in a property and asset manager’s possession.
  - The R/E Consultant negotiated his compensation with the WCB Chair when the contract to perform as portfolio manager for the WCB real estate portfolio was going to be put out for tender. Based on the value of the assets under management, and the work required to perform the duties as set forth in the Agreement, the level of compensation appeared to be reasonable.
  - Each month the R/E Consultant sent an invoice to WCB together with a listing of real estate assets on which his fee calculation was based. These numbers were reconciled with the custodian’s report. Also, any

expenses incurred by the R/E Consultant were included on the monthly invoice, together with receipts. The former CIO or the Director, Investments approved the monthly invoices of the R/E Consultant. Further, compliance with the diversification guidelines in the SIPO document were reviewed regularly by the Investment Department, including each time a real property investment opportunity was proposed to make sure it fitted SIPO pro forma diversification requirements by property type and location.

- The R/E Consultant was also engaged by another Winnipeg-based financial institution to manage that institution's investment in ABC Fund (see **Section 7.8.1**). This was in accordance with his Agreement with the WCB.

## Conclusions

- The Investment Department appropriately managed its relationship with the R/E Consultant. The R/E Consultant's Agreement, including Schedules, was comprehensive, complete and reasonable in the circumstances.
- The R/E Consultant was well-qualified to perform the duties set forth in his Agreement, and generally abided by the Agreement with the exception of the preparation of quarterly and closing reports.
- The compensation and expenses of the R/E Consultant were properly supported and approved.

# 8.0 Recommendations

## 8.1 FOR THE PROVINCE OF MANITOBA

- That consideration be given to:
  - The amendment of The Auditor General Act to extend Section 15(2) No Obstruction and the related Offence Section 15(3) to all audits conducted by the Auditor General.
  - The development of whistle-blowing legislation to protect employees of public sector organizations from retaliation for raising concerns or reporting wrong-doings of an organization's Senior Officers, its Board of Directors, or its employees.
  - The development and implementation of guidelines to be used by Ministers on how to address governance and conflict of interest concerns of public sector organizations for which they are responsible.
  - The provision of an annual report of the total compensation paid to Order-in-Council appointed Board Chairs be provided to the appropriate Ministers, to ensure amounts are consistent with the rates and intent of the Orders-in-Council.

- That the nomination solicitation process for the WCB Board and the subsequent appointment process be reviewed in order to ensure that the processes are fair to all stakeholders, and are conducted in an open and transparent manner. Each stakeholder group should provide the Minister with a slate of names, thus allowing the Minister the flexibility to select among a number of qualified candidates.
- That the appointment of members to the WCB Board be based on ensuring a diverse mix of skills exist on the Board, including financial expertise, investment experience, business acumen and senior management experience, as well as knowledge of compensation issues. A matrix of desired skills and competencies for the WCB Board should be developed by the WCB, to be utilized by all stakeholders in their consideration for selecting their nominations to the Board. The Province should then strive to select public interest representatives with the skills and competencies that are not fulfilled by the employer and worker representatives.
- That the Minister strive to appoint worker representatives to the Board that do not act in professional capacities as worker advocates, in order to ensure no conflict of interest issues arise between their dual role as Board member and as advocate. Stakeholder groups submitting nominations for these Board members should also consider this conflict and submit for consideration the names of individuals who do not have a day-to-day relationship with the WCB.
- That term limits for WCB Board members be established, in order to ensure continual renewal of the Board. Term limits should also be applied to the Chair position.
- That the legislative requirement that the Deputy Minister of Finance serve on the WCB's Investment Committee be reviewed. Whenever a senior government official is a member of a Board or Board Committee, it raises issues as to the role and fiduciary responsibilities of that individual and whether there should be, or there is expected to be, reporting back to the Province from a monitoring perspective.

## Response from the Province

*While this review identified issues to be addressed by the WCB and government, we note that the Workers Compensation Board's tri-partite structure is effective and that Board members are committed to the WCB and its goal of meeting the needs of injured workers. Manitoba's WCB has been one of the few fully-funded Boards in Canada. It has reserves of \$70 million and has posted the second highest investment returns among Canadian WCBs over the past four years. In 2005, Manitoba employers enjoyed the lowest average WCB premiums in Canada. The workplace time-loss injury rate also declined by 21% between 2000 and 2004.*

*The relationship of an agency like the WCB with government and stakeholders is complex. The Workers Compensation Board is funded by employer assessments rather than provincial tax revenues. It is governed by a stakeholder Board of Directors, which operates at an arms-length from government, and is made up of worker, employer, and public interest representatives. Maintaining a constructive and productive working relationship between employer and labour stakeholders has been both a challenge and an essential prerequisite for an effective workers compensation system. We note that the need to find a balance between agency independence and government priorities has been the subject of considerable debate and commentary in Canada.*

*The Board of Directors is the centre of the governance structure for the WCB and as such, is responsible for WCB's strategic direction, safeguarding resources (financial and human), monitoring performance, and is accountable for its actions. Under The Workers Compensation Act, the Board oversees the management of the WCB, including the CEO, and holds them responsible for managing the day-to-day operations.*

*The Minister is responsible for the Act and the broad policies governing the WCB, but has no legal authority to intervene in specific management or claims decisions. In contrast with legislation governing some crown corporations, under The Workers Compensation Act the CEO serves at the pleasure of the Board rather than the government. The Minister is accountable in general to the Legislature for the outcomes of the workers compensation system, but must maintain an arm's length relationship from the WCB. The government takes seriously the stakeholder Board governance system established by the Act, and believes it is a key factor in the success of Manitoba's WCB.*

*Appointed as Chair of the WCB Board by successive governments since 1992, the former Chair had decades of public service in the areas of labour-management relations, constitutional affairs, the military, culture, philanthropy, social services and international trade. His contributions to Manitoba and Canada are well known and significant.*

*This report makes more than 50 recommendations; nine of those recommendations are for government. The government has already taken action to address key recommendations in this report.*

*Of particular importance is The Workers Compensation Amendment Act (Bill 25) which was enacted with the unanimous support of the Legislature in June, 2005 and proclaimed into force on January 1, 2006. As a consequence, Manitoba's legislated WCB governance structure, which had not changed since 1990, will now be one of the strongest in Canada. We are pleased that the amendments address a number of the governance recommendations made in this review:*

- WCB Board members must be appointed for a fixed term not to exceed four years;*
- Provisions are made for staggered terms for WCB Board member appointments;*
- The WCB Board must establish an Investment Committee as a Board committee, accountable to the Board;*
- The WCB Board must establish a stand-alone Audit Committee;*
- WCB Board must establish a Policy and Planning Committee;*
- To obtain outside expertise as required the Board may appoint as many as three additional persons who are not Board members to the Investment and the Audit Committees;*
- Each of the Board committees must be chaired by a member of the Board representative of workers, employers or the public interest (this does not include the Chairperson of the Board);and*
- The longstanding requirement that the Deputy Minister of Finance serve on the Investment Committee has been repealed.*

*The government will take the following steps to act on the remaining recommendations for government in this report.*

*We will take steps to ensure provisions that protect investigations by the Office of the Auditor General (OAG) from obstruction apply to all examinations or audits undertaken under The Auditor General Act.*

*Current whistleblower protections in Manitoba are restricted to social services, health care, workplace safety and health, and drinking water safety. We will develop and introduce comprehensive legislation to protect public sector whistleblowers.*

*We will develop guidelines to assist Ministers should they be presented with concerns about arm's length organizations for which they are responsible. The reporting of compensation for Order in Council appointed Board Chairs will also be reviewed and steps taken to ensure compensation packages appropriately reflect the intent of the Order in Council.*

*We will work in consultation with the WCB Board as well as employer and labour stakeholders to improve the nomination and appointment process for the WCB Board with a view to addressing those recommendations from this review.*

## 8.2 FOR THE WORKERS COMPENSATION BOARD

### Board Governance

- That the structure and activities of each Board Committee be reviewed to ensure each is functioning at the appropriate governance level, and providing value-added examination of information to enhance the Board's decision making.
  - That the practice of the Board Chair serving as Chair of all Committees, be reviewed and reconsidered, especially with respect to an Audit Committee or Finance Committee.
  - That the role of the Policy Committee with respect to human resource matters be reviewed and clarified. The Policy Committee could designate specific meetings, perhaps quarterly, to deal with human resource related matters, such as ensuring that fair and equitable human resource policies are in place and are followed by the organization, as well as reviewing complaints related to human resource matters and human resource-related statistics such as turnover rates, cost of buyouts, etc. Alternatively, a separate adhoc Human Resource Committee could be established to meet on a quarterly basis. Further, an adhoc Committee could be formed for a short time period each year to deal with the CEO evaluation process, or established when necessary for hiring a CEO.
  - That a separate, stand-alone Audit Committee be established and meet at a minimum of quarterly. It would be responsible for overseeing the integrity of the financial reporting process, developing an effective relationship with and directing the scope of external and internal audits, and ensuring compliance with all laws, regulations and internal policies. All members of the Audit Committee should have financial literacy skills. If required, consideration could be given to including non-Board members on the Audit Committee, in either voting or non-voting capacities, to provide financial knowledge or expertise.
  - That the mandate of the Service Committee be reviewed as to the need for a separate Committee to meet on such a frequent basis. Activities could be reallocated to other Committees or in the case of provision of updates and statistical information, this could just be provided to the Board as a whole.
  - That the Board consider establishing Committees on an as-needed basis, to deal with specific items of strategic importance to the Board, which may change as the organization's needs change.
  - That the Board and Committee meeting schedule be re-visited, as not all Committees may need to meet monthly; quarterly or bi-annual meetings may be more appropriate for some Committees.
- That WCB develop a matrix of desired skills and competencies for Board members to be provided to the Minister as information to assist in the



appointment process. This matrix could also be provided to all stakeholder groups in order to assist them in their consideration and selection of individuals for nomination. The matrix should be reviewed and updated on a regular basis to ensure the desired skills and competencies continue to meet the evolving needs of the WCB. Some key areas of governance competency to consider include risk management, financial management, investment expertise, human resources, business acumen, and senior management experience.

- That WCB develop a formal board orientation process to be provided to all new Board members, to ensure that they all have a common understanding of the organization, its strategic direction, risk management issues, and the Board members' responsibility for oversight and monitoring.
- That WCB update its governance manual to ensure it reflects current practices and procedures and assist in ensuring that Board members are clear in their understanding of their stewardship, leadership, responsibility and accountability requirements.
- That periodic training opportunities be provided to Board members in areas that would enhance overall governance, such as finance, risk management, audit committee functioning, and investment management.
- That the conflict of interest policy be reviewed on an annual basis, and that Board members sign a declaration of conflict form each year.
- That the Board conduct formal evaluations of their governance effectiveness and performance on a regular basis.
- That the practice of allocating \$1 million in grants under its Community Initiatives and Research Program be reviewed to ensure a documented rationale exists for the practice and on what basis the annual amount is determined. The work of the Board and/or Committee should be to set the governance direction, rationale and criteria for the approval process. While final approval remains with the Board, WCB staff can review and analyze the proposals, providing the Board with prioritized recommendations based on their approved criteria.

### **Investment Committee Governance**

- That the Investment Committee report and be accountable to the WCB Board, and provide regular reporting to the Board.
- That a majority of the members of the Investment Committee be chosen for their investment and/or investing experience and expertise in the key areas in which the WCB invests.
- That the Investment Committee regularly assess its effectiveness, with a view to ensuring that the performance of the Committee accords with best practices.
- That Advisors to the Investment Committee be chosen carefully against well defined minimum qualifications, and with at least one Advisor



experienced in institutional private placement investing in order to add value to the investment process.

- That the number of members on the Investment Committee be increased in order to function in accordance with best practices in terms of providing governance and guidance to the Investment Department.

**Board Per Diems, Expenses and Other Compensation**

- That a Chair’s compensation be in accordance with the remuneration rate set by the Order-in-Council appointing the Chair.
- That a Chair’s per diem claims be documented on a form similar to the fee reimbursement request form, used by the other Board members, to properly document the meeting dates being claimed, the nature of the meeting, and the duration of meetings attended.
- That a Chair’s per diem and expense claims, and corporate credit card transactions, be forwarded to the Finance Committee of the Board (assuming that the Chair is not the Chair of the Finance Committee) for review and approval.
- That a Chair’s expense account claims and corporate credit card statements are supported by original receipts and that the purpose of the Chair’s travel is clearly documented in all instances.
- That additional attention be given to ensuring all Board member expenses are supported by original receipts.

**Human Resources**

- That the WCB undertake a planned process to enhance their corporate climate to ensure that WCB has a respectful work environment that fosters trust, fairness and an open exchange of ideas and open communication. This includes:
  - That the Harassment Protocol and the Investigations Protocol be updated to provide guidance to managers in fulfilling their responsibility for ensuring a harassment-free environment, while maintaining the ability for individuals to pursue complaints. Once these changes are in place, these policies should be renamed to reflect a proactive approach to creating a respectful workplace;
  - That a comprehensive Human Resource Policy and Procedures Manual be developed which is accessible to all staff and which clearly indicates that all managers are responsible to monitor activities to ensure consistent application of the human resource policies; and
  - That WCB develop human resource policies for its Board of Directors. These policies should include a mechanism for addressing disrespectful behaviour by any Board member and should clearly stipulate that functions hosted by the organization, during or after regular working hours, on or off site, are typically

considered work related and as such fall under the purview of the human resource policies. Further, the human resource policies developed for the Board of Directors should outline the parameters of the Chair and Board members' involvement in day to day personnel matters of WCB.

## Investment Management

### Investment Strategy

- That WCB develop a Comprehensive Investment Strategy for the private placement investment program which considers the following:
  - A breakdown of WCB's returns from its private placement investments, including an analysis of where they have been successful, unsuccessful and the lessons learned;
  - A situational analysis including a description of the private placement market in and outside of Manitoba, and WCB's market positioning (funds seeking capital, sources of quality deal flow, competitors, financial institutions and other possible co-investors);
  - As a benchmark, historical venture capital and private equity returns in Canada, and separately in the United States;
  - Realistic return on investment objectives for Manitoba-based investments opposite return results for the rest of the venture capital and private equity industry;
  - Human resource considerations such as in-house expertise and experience, and resources available to WCB on an outsourced basis both inside and outside of Manitoba;
  - How the private placements portfolio is to be constructed and how it is expected to look at future points in time, including in terms of balance and diversification;
  - Discrete and realistic investment targets, including timing, for private placement and real estate investments including a clear and definitive allocation of capital, thereto; and
  - What WCB is and is not looking for in terms of private placements including individual investment size, industry sectors, stages of development, location, control positions (versus significant influence), the optimum number of investments in the portfolio, etc.
- That the SIPO document be improved by:
  - Formulating WCB's private placements vision, comprehensive investment strategy and tactics to be undertaken to realize that vision;
  - Developing an appropriate "investment processes and procedures" addendum;

- Revising Appendix II *“Underwriting Criteria for Venture Capital”* so that it is a comprehensive and complete template with regard to investing in institutional private placement investments;
- Creating a frame-of-reference for assertions as to expectations for return on investment such as the CVCA’s return statistics;
- Modifying definitions used in the SIPO document, such as “private placements” and “institutional investor”, to conform with those used by the Canadian venture capital and private equity industry; and
- Clarifying the nature and objective of private placement investments in Manitoba, as now described under “the fourth investment belief”.

### **Portfolio Construction**

- That as part of portfolio construction, and within a coherent investment strategy, consideration be given to allocating private placement investment to high quality institutional investment opportunities located outside of Manitoba, as well as within Manitoba.

### **Investment Approvals**

- That Investment Committee Agendas become stand-alone documents containing a reasonable amount of the information necessary to support private placement investment recommendations.
- That the Investment Department improve due diligence performed in support of each investment recommendation, and that evidence of that work be maintained in their files.

### **Investment Management, Monitoring and Internal Reporting**

- That a closing memo be prepared each time a private placement investment is booked, including when another round of financing is done, and be automatically provided to the Investment Committee for their edification.
- That, on a quarterly basis, and in accordance with the SIPO document, the Investment Department provides the Investment Committee with a fulsome report regarding the progress, status and performance of private placement investments.
- That realized and unrealized gains and losses for individual private placement investments, and for the portfolio taken as a whole, be presented to the Investment Committee regularly for performance measurement purposes.
- That as an integral part of an addendum to the SIPO document, minimum documentation requirements for what should be maintained in each private placement investment’s current monitoring files be developed.

- That when the requirements of the SIPO document are not followed, that the exceptions be documented by the Investment Department (for the files) and the Investment Committee (in the minutes).
- That the Finance and Investment Departments convert from their Discounted Cash Flow performance measuring stick to the Internal Rate of Return industry standard.
- That the \$2.0 million deemed carrying value be supported with a formal valuation report prepared by a valuation expert once the operating performance of the investment can be assessed.

### **Staffing Adequacy**

- That the CIO position is filled as soon as possible with someone with significant investment experience.
- That the CIO prepares a job description for the Director, Investments.
- That the CIO includes private placements and real estate investing training activities in the Investment Department training budget.
- That the CIO and/or the Director, Investments consider the benefits of joining and participating in either or both of the Canadian Venture Capital Association (CVCA) and the Institutional Limited Partners Association (ILPA), as an opportunity to participate in their conferences and training sessions, and take advantage of opportunities to establish good industry contacts and learn industry best practices.

### **Private Placement Investments**

- That the Investment Committee and its Advisors make their responsibility of “generating the highest possible return” the primary consideration in approving private placement investments.
- That the Investment Department actively respond to significant private placement reporting deficiencies, and that such shortfalls be reported to the Investment Committee on a timely basis.
- That the Investment Committee follow-up on private placement investments that are experiencing difficulties either through instructions to the Investment Department, or by employing outside advisors on a special project basis.

### **Winnipeg-Based Real Estate Investments**

- That investment opportunities, only be formally brought before the Committee by its Chair and the CIO as an Agenda item after an investment is properly structured, and when most of the major investment issues have been appropriately resolved by the Investment Department.
- That the WCB principally focus on encouraging the presentation of investment opportunities to the Investment Committee that are

consistent with the Investment Committee Mandate in the SIPO document to “generate the highest possible return”.

#### **Real Estate Consultant’s Portfolio Management**

- That either the R/E Consultant prepare quarterly and closing reports in accordance with his Agreement or that the Agreement be amended to reflect what the Investment Committee and Department require.
- That the R/E Consultant provide more detail regarding the Winnipeg-based real estate investments in his reporting to WCB.

#### **Conflict of Interest Situations**

- That in all WCB investment matters, conflict of interest situations be avoided.
- That conflict of interest situations result in a quarterly certification by each person involved in the private placements investment process, and that the conflict of interest certifications require a declaration that no conflict of interest exists, or that conflicts do exist as detailed in the declaration. These conflict of interest certifications should be made available to all members of the Board of Directors and Investment Committee for comment and follow-up, as may be required.
- That investment projects that serve another objective, such as helping a separate party such as an investment fund with its own business objective of generating additional income through gathering and managing pools of institutional capital (particularly when one considers the existing conflicts of interest), be avoided.
- That investments that have to be structured and documented for legal purposes in an unusually complex manner, in order to overcome built-in difficulties (such as conflict of interest, and terms and conditions that clearly favour one party over the other), be avoided.

## Response from The Workers Compensation Board

*The Workers Compensation Board (WCB) would like to thank the Office of the Auditor General (OAG) for its review of Governance, Human Resource, and Investment issues. As noted by the Auditor General, the WCB is in good financial condition. It is one of the few fully-funded WCBs in Canada, has posted above average investment returns, and in 2005, Manitoba employers enjoyed the lowest average premium rates in Canada. Nonetheless, the Board will be greatly strengthened by recently proclaimed new legislation, organizational changes already made or in progress and the OAG's helpful recommendations.*

### **Governance**

*Recently proclaimed amendments to The Workers Compensation Act enhance Board and Investment Committee governance and address many of the Auditor General's concerns. Important changes include:*

- *the Investment Committee is now accountable to the WCB Board of Directors and the Deputy Minister of Finance is no longer a member of this Committee;*
- *a Board member other than the Chairperson now chairs each Board Committee;*
- *there is a stand-alone Audit Committee; and*
- *both the Investment Committee and the Audit Committee have the ability in statute to include up to three non-Board members to provide investment, financial, and audit expertise.*

*In addition, numerous other governance-related initiatives have been undertaken by the WCB, some with the assistance of a governance consultant to provide expert advice in this important area. Examples include:*

- *reviewing the terms of reference for all Board Committees;*
- *updating the governance manual;*
- *enhancing Board orientation and training, with particular emphasis on governance and financial matters;*
- *strengthening processes related to conflict of interest, as well as per diems and expenses;*
- *developing a Board self-assessment process to review Board effectiveness;*
- *developing criteria for selecting non-Board members of the Audit Committee and the Investment Committee; and*

- *streamlining the Board approval process for Community Initiatives and Research Program funding proposals.*

*We will also work with the government to develop a matrix of competencies for WCB Board members.*

*The Board continues to see considerable value in emphasizing the importance of customer service and monitoring performance in this area through the establishment of a separate Service Committee. This Committee will also be responsible for Human Resource matters and the Community Initiatives and Research Program. The latter is a critical tool in reaching our current goals with respect to safety in the workplace and benefits both workers and employers.*

*We are proud of the Board's tradition of consensus in its decision-making and consider it to be a model for labour management relations. Consensus achieved after full and frank discussion among Board members reflects a collaborative approach to achieving the best interests of the WCB stakeholders, recognizing the unique nature of the tripartite Board and the potential for conflicting points of view.*

*While recognizing the modern day governance requirement for a Chair not to become overly involved in day-to-day operational and management activities, the Board wishes to recognize the passion, commitment and tireless dedication of the former Chair to the WCB.*

### **Human Resources**

*The WCB is committed to ensuring a respectful workplace. In 2004 and 2005, all WCB personnel, including senior management, were required to participate in equity and diversity training, which included respectful workplace principles. In April 2005, the WCB established a Joint Respectful Workplace Committee to recommend a protocol/policy to deal with respectful workplace issues and a strategy to further enhance awareness of respectful workplace behaviours. This Committee's work is ongoing and Respectful Workplace training is planned for early 2006.*

*In addition, the WCB will review, update and enhance our human resource policies to address the recommendations of the Auditor General.*

### **Investments**

*The WCB operates a well-diversified, conservatively-managed investment portfolio. In 2004, the investment return of 11.8% was the second best of the WCBs in Canada.*

*With respect to the recommendations for further improvement to our management of private placements, the WCB will undertake to: more fully address private placements in our Statement of Investment Policies and Objectives; continue to improve documentation supporting investment proposals, as well as management and monitoring reports; update the job descriptions of investment staff; provide additional professional*



*development opportunities for investment staff; and enhance guidelines for avoiding conflict of interest situations.*

*The WCB carefully considers the appropriate balance of investment opportunities both inside and outside of Manitoba and will continue to invest in Manitoba in those situations where the investment makes good business sense and the rate of return is appropriate.*

### ***Openness and Transparency***

*We fully agree with the need to be open and transparent. Therefore, we worked hard to resolve issues that arose during the course of the audit.*

## SUMMARY OF THE JANUARY 2005 SIPO DOCUMENT

## Appendix A

### Statement of Investment Beliefs

- 1) The need for a diversified investment portfolio to optimize the return.
- 2) Acknowledgement of the relationship between risk and return.
- 3) The need for active management (flexibility in managing the weighting of elements of the benchmark portfolio).
- 4) The rationale for investing in Manitoba provided that comparable returns are anticipated (known later in this report as “the fourth belief”).
- 5) The responsibility to invest in entities with high standards regarding human rights and working conditions.
- 6) The rationale for using both internal and external resources to source and manage certain types of investments.
- 7) The desire to use local providers of investment expertise provided that quality is not compromised.

### Purpose of the Investment Objectives/Policy Statement

- To ensure that all members of the Investment Committee and WCB clearly understand the goals and direction of the investment function. To facilitate the delegation of investment management responsibilities. To act as an anchor in turbulent times when it may appear appropriate to abandon the established investment disciplines.

### Investment Committee Mandate

- Three members – Chairperson of the WCB, an employer representative, and the Deputy Minister of Finance of MB or his/her designate. Committee responsibilities – ensure the matching of assets with WCB assumed liabilities, minimize the risk of capital loss, and generate the highest possible return. At least quarterly meetings to review investment performance, investment manager performance, investment opportunities, investment outlook, and investment policy changes.

### Investment Objectives

- To generate a consistent, positive, real rate of return on invested assets which will provide for repayment of all WCB liabilities, as required. Policy asset mix (proportional allocation of assets to various classes) and characteristics of the return expectations of each. Performance results to be measured annually. Minimum target real rate of return of 4%. Peer ranking of 2<sup>nd</sup> quartile or better on a 4 year compounded basis.

### Investment Policies

- Minimum and maximum asset mix ranges (based on market values), and the rebalancing frequency (no less often than quarterly).

## Appendix A (cont'd.)

### Diversification Guidelines

- Regarding publicly traded capital stock (limited to TSX, NYSE, NASDAQ and AMEX with holding limits – 8% of any individual investment manager’s portfolio and 5% of the voting shares of any corporation) , bonds, mortgages (by property type and region), real estate (by property type and location), short-term investments (only securities with a DBRS R-1 rating are permissible), and exceptions (policy violations are to be reported by the Treasurer to the Investment Committee to take remedial action).

### Private equity investments

- (Private equity investments include venture capital and fund-of-fund investments – all of which are also referred to in SIPO as “private placements”) are not to be made without the prior written approval of the Investment Committee. The guidelines for making such investments are found in SIPO’s Appendix II – “Underwriting Criteria for Venture Capital”.

### Real estate investment

- Underwriting guidelines are found in SIPO’s Appendix III. Other key real estate investment guidelines within SIPO in addition to Appendix III include the following:
  - Real estate investments include, in addition to direct ownership, indirect ownership through a bond instrument, real estate fund or corporation provided that the underlying asset and revenue stream is directly tied to the property’s income;
  - Single family residential investments are excluded;
  - Office, retail, land, industrial, multi-family residential and hotel/ mixed use projects are all allowed investments;
  - No individual purchase or market value to exceed 15% of the policy allocation (asset mix) to the real estate portfolio;
  - Real estate can be purchased using 3<sup>rd</sup> party mortgages secured by the property purchased;
  - Non-recourse mortgages can be excluded in the portfolio asset mix test;
  - Recourse to WCB mortgages are allowed but cannot be committed without Investment Committee prior approval;
  - The real estate portfolio yield minimum target is 125% of the current conventional mortgage yield; and
  - Development projects should not exceed 20% of the portfolio, and require a minimum of 60% pre-leasing signed commitments and fixed price construction contracts in place before construction can proceed.

## Appendix A (cont'd.)

### Conflicts of Interest

- This standard applies to all members of WCB's Board of Directors, the Investment Committee, and WCB agents including external investment managers. Material ownership of securities conflicts are to be disclosed. Other than normal and reasonable fees and expenses incurred in the discharge of their duties (provided that these are documented and approved by the Board), personal financial gain because of a person's fiduciary position is prohibited. Real or apparent conflicts of interest are to be reported to the Chairperson of the Board for a decision as to what is appropriate under the circumstances and all such conflicts are to be tabled at the next regular meeting of the Board. No gifts or gratuities or personal favours allowed other than those of nominal value.

### Annual Review

- SIPO is to be reviewed at least annually.

### Authority and Responsibility of the Chief Investment Officer

- The Investment Committee delegates the responsibility and signing authority to the CIO regarding 4 main functions:
  - Investment Policy and Objectives;
  - Investment Management;
  - Fund Administration; and
  - Implementing Decisions.

## Appendix B

### GLOSSARY OF TERMS

Due diligence	The process of assessing the business and financial viability of a potential investment target, as well as the potential terms and conditions of an investment agreement.
Gatekeeper	A professional advisor or intermediary operating in the private equity market on behalf of clients, such as institutional investors.
Institutional investor	Pension funds, insurance companies, endowments, charitable foundations, mutual funds and other non-bank financial institutions that are often key suppliers to private equity funds. In Canada, certain large institutional investors also have in-house programs for direct market activity.
Internal rate of return (IRR)	The discount rate equating the present value of cash outflows with the present value of cash inflows.
Limited partnership (LP)	A legal fund structure most frequently used by Private-Independent Funds to raise capital from external sources, such as institutional investors. The primary relationship in this structure is the general partner (the fund manager) and the limited partner (the capital source).
Management company	The professional manager of a private equity fund or funds.
Private equity	The generic term for the private market reflecting all forms of equity or quasi-equity investment. In a mature private equity universe, there are generally three distinct market segments: Buyout Capital, Mezzanine Capital and Venture Capital.
Venture capital	A specialized form of private equity, characterized chiefly by high-risk investment in new or young companies following a growth path in technology and other value-added sectors.

## R/E CONSULTANT PORTFOLIO MANAGEMENT AGREEMENT (SUMMARIZED)

## Appendix C

### Effective Date

- Similar to and in connection with the development of SIPO, the Agreement has evolved and been upgraded periodically over the past 4-5 years. The latest update of the 11 page Agreement (plus Schedules) most recently made as of the 1<sup>st</sup> day of April, 2003 was on March 7, 2005.

### Appointment

- R/E Consultant appointed portfolio manager to manage the real property portion of WCB investments in accordance with SIPO and subject to the supervision of the WCB.

### Duties

- Ensure appropriate management of individual real estate assets by professional asset and property managers, and in the case of certain assets in Manitoba, provide those asset management services. In addition, the Consultant is to:
  - Seek out investment opportunities – acquisitions and dispositions – bringing same to the attention of WCB, providing necessary analysis and recommendations, and if approved by WCB negotiate with other parties and manage the transaction using WCB staff and legal and financial advisors;
  - Provide reports on the real estate portfolio and property managers' activities including: a closing report upon the completion of the transaction addressing status, financial information and other information the WCB may require; quarterly reports addressing the performance of the portfolio, the status of pending transactions, and other matters; and an annual report within 90 days of WCB's year end;
  - Provide or cause to be provided appropriate records for accounting for the portfolio transactions and their fair values;
  - Represent the WCB at meetings subject to WCB direction;
  - Arrange for independent property appraisals on each property on a rotating 3 year cycle; and
  - Carry out other related duties including alerting the WCB of any issues, concerns, or trends that may impact the portfolio, recommending remedial action, and implementing such action once approved.

### Books and Records

- Complete and accurate books and records are to be maintained relating to all real property investments, including records relating to the accounting for each transaction. All books and records are the property of the WCB.

## Appendix C (cont'd.)

### Sub-Advisory Agreements

- The Consultant may enter into sub-advisory agreements with asset managers to provide investment management and advisory services on terms and conditions similar to those contained in his Agreement.

### Fees

- The Consultant is responsible for and shall pay for maintaining the staff and personnel and providing the office space, facilities, and equipment necessary to perform its obligations under this Agreement. The WCB shall pay to the Consultant, monthly in arrears against an invoice, a fee (subject to amendment from time to time) of [XX] basis points multiplied by the allocation to real estate, i.e., after December 31, 2004 the fee is [XX] of the market value of committed and disbursed investments in the real estate portfolio.

### Indemnification, Representations and Warranties

- All as would be expected in the normal case.

### Term and Termination

- The Agreement is effective for an indefinite term and may be terminated by either WCB or the Consultant by providing at least 90 days prior written notice.

### Conflicts of Interest

- The Consultant may act as a portfolio manager for other persons. If a conflict situation develops either in appearance or in fact, the WCB shall be advised and the WCB's decision regarding the handling of the conflict is to be final. He is to provide a list of his other clients to the WCB on a monthly basis, together with billing invoices. Neither the Consultant nor any officer, associated firm, nor any person related to them, shall receive a fee, commission, gift or favour from a vendor, vendor's broker, or other party arising from an acquisition or disposition or any asset into the real estate portfolio.



## INVESTMENT RETURNS FOR PERIODS ENDED DECEMBER 31, 2004

## Appendix D

- CVCA return statistics for funds located all across Canada to December 31, 2004 indicate that the gross 10 year return (annual internal rate of return) on “all venture capital” was 3.6% compared to 21.5% for private equity (“buyouts and mezzanine” transactions). Combined, the 10 year gross return for all venture capital and private equity is 9.5%.
- The use of gross return means that the costs of managing the funds, approximating 2.0% annually, have not been deducted from the gross return of each fund’s investment portfolio.
- The gross returns of the top quartile funds in the CVCA results were:
  - All venture capital (VC) - 9.1%;
  - Private equity (PE) - 23.0%; and
  - All VC and PE - 14.1%.

