Financial Statements of

HEALTHCARE EMPLOYEES' BENEFITS PLAN - MANITOBA - DISABILITY AND REHABILITATION PLAN

Year ended December 31, 2012

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of Healthcare Employees' Benefits Plan - Manitoba - Disability and Rehabilitation Plan

We have audited the accompanying financial statements of the Healthcare Employees' Benefits Plan - Manitoba - Disability and Rehabilitation Plan, which comprise the statement of financial position as at December 31, 2012, the statements of changes in net assets available for benefits and changes in benefit obligations for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for pension plans, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Healthcare Employees' Benefits Plan - Manitoba - Disability and Rehabilitation Plan as at December 31, 2012, and its changes in net assets available for benefits and its changes in benefit obligations for the year then ended in accordance with Canadian accounting standards for pension plans.

KPMG LLP

Chartered Accountants

June 19, 2013

Winnipeg, Canada

HEALTHCARE EMPLOYEES' BENEFITS PLAN - MANITOBA - DISABILITY AND REHABILITATION PLAN

Statement of Financial Position

December 31, 2012, with comparative figures for 2011

	2012	2011
Assets		
Cash	$ 6,021,729	$ 6,014,495
Premiums receivable	2,860,377	2,584,434
Other receivables	239,716	127,449
Prepaid expenses	50,604	52,077
Due from Manulife Financial (note 3)	55,150	71,806
Capital assets (note 4)	342,725	514,088
Investments (note 5)	181,313,768	167,702,144
Total assets	$ 190,884,069	$ 177,066,493
Liabilities		
Claims payable and accrued liabilities	$ 791,276	$ 706,733
Government remittances payable	365,311	352,864
Due to Healthcare Employees' Pension Plan - Manitoba (note 14)	439,605	579,806
Obligation for IBNR (note 8)	22,397,000	19,159,000
Total liabilities	23,993,192	20,798,403
Net assets available for benefits	166,890,877	156,268,090
Actuarial value of benefit obligations (note 9): Disabled lives	102,849,000	88,645,000
Commitment (note 15)		
Excess of net assets available for benefits over benefit obligations (note 10)	$ 64,041,877	$ 67,623,090

See accompanying notes to financial statements.

Approved by the Trustees:

______________________ Chair

______________________ Vice-Chair

HEALTHCARE EMPLOYEES' BENEFITS PLAN - MANITOBA - DISABILITY AND REHABILITATION PLAN

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2012, with comparative figures for 2011

	2012	2011
Increase in net assets:		
Premiums	$ 39,311,865	$ 36,675,250
Investment income	13,732,076	6,958,389
Current period change in fair value of investments	–	6,490,228
	53,043,941	50,123,867
Decrease in net assets:		
Current period change in fair value of investments	5,542,015	–
Claims incurred	27,404,842	23,789,117
Claims - related expenses	1,478,674	1,086,605
Administrative expenses (notes 6 and 14)	4,757,623	4,516,477
	39,183,154	29,392,199
Increase in net assets before change in obligation for IBNR	13,860,787	20,731,668
Change in obligation for IBNR	(3,238,000)	1,022,000
Increase in net assets available for benefits	10,622,787	21,753,668
Net assets available for benefits, beginning of year	156,268,090	134,514,422
Net assets available for benefits, end of year	$ 166,890,877	$ 156,268,090

See accompanying notes to financial statements.

HEALTHCARE EMPLOYEES' BENEFITS PLAN - MANITOBA - DISABILITY AND REHABILITATION PLAN

Statement of Changes in Benefit Obligations

Year ended December 31, 2012, with comparative figures for 2011

	2012	2011
Actuarial value of benefit obligations, beginning of year	$ 88,645,000	$ 81,803,000
Claims accrued	38,318,000	40,363,000
Claims paid	(28,883,000)	(24,876,000)
Interest accrued on benefits	3,744,000	3,343,000
Effect of experience gains and losses	(4,813,000)	(14,072,000)
Effect of addition of cost of living benefits	3,930,000	2,737,000
Effect of change in valuation basis	1,908,000	(653,000)
Actuarial value of benefit obligations, end of year	$ 102,849,000	$ 88,645,000

See accompanying notes to financial statements.

1. General and description of the Plan:

The Healthcare Employees' Benefits Plan - Manitoba (HEBP) is jointly trusteed which includes the disability and rehabilitation plan (the Plan) for healthcare employees in Manitoba.

The Plan is registered as a health and welfare trust under the *Income Tax Act* and is not subject to income taxes.

The Plan was established on October 1, 1988 to administer the long-term disability plan for employees of participating healthcare facilities of Manitoba. The employees' share of the Plan was insured with Manulife Financial for claims with disability dates on or before May 31, 2002 (Insured Plan). The employers' share of the Plan was self-insured for claims with disability dates on or before May 31, 2002, but administered by Manulife Financial on an Administrative Services Only (ASO Plan) basis. Claims adjudication for the Plan is provided by Manulife Financial for claims with disability dates on or before May 31, 2002. Claims with disability dates on or after June 1, 2002 are self-administered and self-insured.

2. Significant accounting policies:

(a) Basis of presentation:

The Plan follows the Canadian accounting standards for pension plans for accounting policies related to its investment portfolio and benefit obligations. In selecting or changing accounting policies that do not relate to its investment portfolio or benefit obligations, the Plan complies on a consistent basis with Canadian accounting standards for private enterprises.

These financial statements are prepared on a going concern basis and present the aggregate financial position of the Plan as a separate financial reporting entity, independent of the participating employers and members. Only the assets and obligations to members eligible to participate in the Plan have been included in these financial statements. These financial statements do not portray the funding requirements of the Plan or the benefit security of the individual plan members.

2. Significant accounting policies (continued):

(b) Financial instruments:

Financial instruments are recorded at fair value on initial recognition. Freestanding derivative instruments that are not in a qualifying hedging relationship, cash and investments are subsequently measured at fair value. All other financial instruments are subsequently measured at cost or amortized cost, unless management has elected to carry the instruments at fair value. The Plan has elected not to carry any such financial instruments at fair value.

Transaction costs incurred on the acquisition of financial instruments measured subsequently at fair value are expensed as incurred. All other financial instruments are adjusted by transaction costs incurred on acquisition and financing costs. These costs are amortized using the straight-line method.

(c) Fair value measurement:

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. The Plan uses closing market price for fair value measurement.

When available, the Plan measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Plan establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models.

2. Significant accounting policies (continued):

All changes in fair value, other than interest and dividend income, are recognized in the statement of changes in net assets available for benefits as part of the current period change in fair value of investments.

Bond pooled funds are recorded at fair values established by the respective fund trustee.

(d) Investment transactions and income recognition:

(i) Investment transactions:

Investment transactions are accounted for on a trade date basis.

(ii) Income recognition:

Investment income includes interest and dividend income. Investment income has been accrued as reported by the issuer of the pooled funds.

(e) Capital assets:

Capital assets are recorded at cost less accumulated amortization. Repairs and maintenance costs are charged to expense. Betterments which extend the estimated useful life of an asset are capitalized. When a capital asset no longer contributes to the Plan's ability to provide services, its carrying amount is written-down to its residual value. Capital assets, which include computer projects, will be amortized on a straight-line basis over three years as the projects are completed.

(f) Premiums:

Premiums recorded in the statement of changes in net assets available for benefits include the employees' and employers' share of the premiums required for the disability coverage. Premiums are recorded on an accrual basis.

2. Significant accounting policies (continued):

(g) Claims:

Claims are recorded in the period in which they are paid or payable. Any claims not paid at fiscal year-end are reflected in claims payable and accrued liabilities.

(h) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of increases and decreases in net assets during the year. Significant items subject to such estimates and assumptions include the determination of the actuarial value of benefit obligations. Actual results could differ from those estimates.

3. Due from Manulife Financial:

Due from Manulife Financial represents the ASO Plan surplus of $55,150 (2011 - $71,806). At May 31, 2002, the Trustees terminated the insured arrangement with Manulife Financial for claims with disability dates on or after June 1, 2002. Manulife Financial holds reserves to fund the fully insured portion of the claims with disability dates on or before May 31, 2002 until the release of all related liabilities.

Interest is earned on the due from Manulife Financial as follows: unrestricted deposit account balance at the 1-year GIC rate less 0.5 percent and on cash flows at 90-day T-bill rate less 0.5 percent.

Manulife Financial is to provide the Plan with terminal accounting in respect of the Insured Plan for the twelve year period from June 1, 2002 to May 31, 2014. The deficit of the Insured Plan as at May 31, 2002 will be carried over as the opening balance for the terminal accounting period, with the $1,800,000 payment applied as a premium payment in the terminal accounting period. Any surplus generated during the terminal accounting period will first be applied to the deficit carried forward from May 31, 2002 and any other deficits arising during the terminal accounting period. Manulife Financial is obliged to pay the Plan any remaining surplus at the end of the terminal accounting period within 60 days thereof, together with interest from May 31, 2014 to the date of payment. Should the Insured Plan generate a deficit during the terminal accounting period or generate a surplus that is insufficient to eliminate the deficit existing as of May 31, 2002, no further amounts shall be owing or paid by the Plan in respect of any deficit existing at the end of the terminal accounting period.

4. Capital assets:

	Cost	Accumulated amortization	2012 Net book value	2011 Net book value
Computer projects	$ 1,769,507	$ 1,426,782	$ 342,725	$ 514,088

5. Investments:

	2012	2011
Bond pooled funds	$ 181,313,768	$ 167,702,144

Investments are held in bond pooled funds which earned a return of 4.8 percent (2011 - 8.9 percent).

6. Administrative expenses:

	2012	2011
Salaries and benefits	$ 2,869,235	$ 3,002,219
Investment management fees	169,949	255,845
Amortization of capital assets	171,363	98,949
Trustee and custodial fees	82,165	81,701
Actuarial fees	144,430	42,629
Audit fees	41,607	44,237
Legal fees	66,915	13,812
Other administrative expenses	1,211,959	977,085
	$ 4,757,623	$ 4,516,477

7. Role of the actuary:

The actuary, Morneau Shepell, has been appointed pursuant to the Trust Agreement. With respect to the preparation of financial statements, the actuary has been engaged to carry out an estimation of the Plan's obligations for IBNR and disabled lives to the members. The estimation is made in accordance with accepted actuarial practice and reported thereon to the Board of Trustees. In performing the estimation of the liabilities, which are by their nature inherently variable, assumptions are made as to future claims, members' ages, benefit amounts, rates of recovery and interest rates.

8. Obligation for incurred but not reported (IBNR):

The obligation for IBNR relates to those claims which have been incurred but not reported at the date of the financial statements. This obligation is calculated as the estimated claims cost for six months.

9. Benefit obligations - disabled lives:

This obligation for disabled lives is calculated annually by Morneau Shepell, an independent actuary, under each plan for every disabled member receiving benefits. As at December 31, 2012, the date of the most recent actuarial valuation, the actuarial value of benefit obligations for disabled benefits was $102,849,000 (2011 - $88,645,000). It reflects the liability for future benefit payments and is developed on the basis of the member's age, benefit amount and normal rates of recovery and an assumed interest rate of 2.05 percent (2011 - 2.08 percent). The next actuarial valuation will be prepared as at December 31, 2013.

10. Excess of net assets available for benefits over benefit obligations:

The Board of Trustees has approved the establishment of a stabilization reserve consisting of the claims fluctuation reserve, operational risk reduction reserve, and investment reserve. The claims fluctuation reserve has been established at an amount equal to 10 percent of the current year's premiums and is fully funded. The operational risk reduction reserve has been established at an amount equal to 10 percent of the current year's premiums. The investment reserve has been established at an amount equal to 10 percent of the current year's disabled life reserve plus IBNR. At December 31, 2012, the Board of Trustees has restricted $20,300,000 (2011 - $18,180,000) of the excess of net assets available for benefits over benefit obligations for these reserves.

11. Capital management:

The main objective of the Plan is to sustain a certain level of net assets, including internally restricted funds, in order to meet the obligations of the Plan. The Plan fulfills its primary objective by adhering to specific investment policies outlined in its Statement of Investment Policies and Procedures (the SIPP), which is reviewed annually by the Plan. The Plan manages net assets by engaging knowledgeable investment managers who are charged with the responsibility of investing existing funds and new funds (current year's employee and employer contributions) in accordance with the approved SIPP. Increases in net assets are a direct result of investment income generated by investments held by the Plan and contributions into the Plan by eligible employees and by the employers. The main use of net assets is for claim payments to eligible Plan members.

12. Risk management:

(a) Market risk:

(i) Interest rate risk:

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments. The Plan's fixed income investments are exposed to the risk that the value of interest-bearing investments will fluctuate due to changes in the level of market interest rates. The Plan's exposure to interest rate risk is concentrated in its investment in the bond pooled funds. To properly manage the Plan's interest rate risk, appropriate guidelines on the weighting and duration for fixed income investments are set and monitored.

The remaining terms to contractual maturity of fixed income investments at December 31 are as follows:

	2012	2011
One to five years	$ 89,757,769	$ 81,590,170
After five years	91,555,999	86,111,974
Total market value	$ 181,313,768	$ 167,702,144

As at December 31, 2012, if the prevailing interest rates were raised or lowered by 100 basis points, with all other factors held constant, net assets would likely have decreased or increased, respectively, by approximately $11,518,000 (2011 - $9,358,000). The Plan's interest rate sensitivity was determined based on portfolio weighted duration.

(ii) Foreign currency and other price risk:

The Plan believes it is not exposed to foreign currency or any other price risk in relation to the Plan's financial instruments.

12. Risk management (continued):

(b) Credit risk:

The Plan is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due or requested. The Plan's greatest concentration of credit risk is in its fixed income securities. The fair value of the fixed income securities includes consideration of the creditworthiness of the debt issuer. All transactions in listed securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal, as payment is made on a purchase once the securities have been received from the broker. For sales transactions, the securities are released once the broker has made payment.

The breakdown of the Plan's bond pooled funds by credit ratings from various rating agencies is presented below:

Credit rating	2012 Fair value		2011 Fair value	
AAA	$ 59,279,557	32.7%	$ 67,936,139	40.5%
AA	42,030,117	23.2%	37,045,404	22.1%
A	56,227,935	31.0%	46,788,898	27.9%
BBB	9,472,067	5.2%	14,573,316	8.7%
BB	884,934	0.5%	–	0.0%
B	9,364,356	5.2%	–	0.0%
Not rated	1,343,788	0.7%	–	0.0%
Short-term investments	2,711,014	1.5%	1,358,387	0.8%
	$ 181,313,768	100.0%	$ 167,702,144	100.0%

Credit risk associated with premiums and other receivables is minimized due to their nature. Premiums are collected from participating members through the payroll process. In 2012, a provision for doubtful other receivables of $18,720 (2011 - $133,943) has been recorded.

(c) Liquidity risk:

Liquidity risk is the possibility that investments of the Plan cannot be readily converted into cash when required. The Plan may be subject to liquidity constraints because of insufficient volume in the markets for the securities of the Plan or other securities may be subject to legal or contractual restrictions on their resale. Liquidity risk is managed by investing the majority of the Plan's assets in investments that are traded in an active market and can be readily disposed. The Plan's claims payable and accrued liabilities and due to HEPP balances have contracted maturities of less than one year.

12. Risk management (continued):

(d) Claims and premiums risk:

The nature of the unpaid claims is such that the establishment of obligations is based on known facts and interpretation of circumstances, on a case by case basis, and is therefore a complex and dynamic process influenced by a variety of factors.

Consequently, the establishment of obligations and premium rates relies on the judgment and opinions of a number of professionals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining premium rates and reserves necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

13. Fair value of financial instruments:

The fair value of the financial assets and liabilities of the Plan approximates their carrying value due to their short-term nature (except cash and investments which are stated at fair value, note 5).

The Plan's assets which are recorded at fair value are required to be classified into one of three levels, depending on the inputs used for valuation. The hierarchy of inputs is summarized below:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

13. Fair value of financial instruments (continued):

Changes in valuation methods may result in transfers into or out of an investment's assigned level.

The following is a summary of the classifications used as of December 31 in valuing the Plan's investments carried at fair value:

December 31, 2012	Level 1	Level 2	Level 3	Total
Cash	$ 6,021,729	$ –	$ –	$ 6,021,729
Bond pooled funds	1,379,705	179,934,063	–	181,313,768
	$ 7,401,434	$ 179,934,063	$ –	$ 187,335,497

December 31, 2011	Level 1	Level 2	Level 3	Total
Cash	$ 6,014,495	$ –	$ –	$ 6,014,495
Bond pooled funds	–	167,702,144	–	167,702,144
	$ 6,014,495	$ 167,702,144	$ –	$ 173,716,639

There were no transfers between Level 1 and Level 2 in the years ended December 31, 2012 and 2011.

14. Related party transactions:

HEBP and the Healthcare Employees' Pension Plan - Manitoba (HEPP) have a certain number of common trustees and a cost sharing agreement to allocate certain costs based on factors such as square footage, number of employees and time usage. The balance due to HEPP is non-interest bearing, and has no fixed terms of repayment.

15. Commitment:

The Plan leases office space under various operating leases with varying expiry dates up to December 31, 2017. The Plan's allocation of annual lease payments to expiry is as follows:

2013	$ 195,000
2014	195,000
2015	197,000
2016	199,000
2017	199,000
	$ 985,000