

## *Educational Note*

# Provision for Future Administration Expenses to be Included in Public Personal Injury Compensation Plans' Financial Statements

## Committee on Workers' Compensation

September 2009

Document 209094

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*Members should be familiar with educational notes. Educational notes describe but do not recommend practice in illustrative situations. They do not constitute Standards of Practice and are, therefore, not binding. They are, however, intended to illustrate the application (but not necessarily the only application) of the Standards of Practice, so there should be no conflict between them. They are intended to assist actuaries in applying Standards of Practice in respect of specific matters. Responsibility for the manner of application of Standards of Practice in specific circumstances remains that of the members in the workers' compensation practice area.*

## Memorandum

**To:** All Public Personal Injury Compensation Plan Practitioners

**From:** Tyrone Faulds, Chairperson  
Practice Council  
Richard Larouche, Chairperson  
Committee on Workers' Compensation

**Date:** September 25, 2009

**Subject:** **Educational Note: Provision for Future Administration Expenses to be Included in Public Personal Injury Compensation Plans' Financial Statements**

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This educational note is intended to assist actuaries in determining and disclosing a provision for future administration expenses to be included in the financial statements of a Public Personal Injury Compensation Plan. It is intended that this guidance will help narrow the range of practice in this area.

In accordance with the Institute's Policy on Due Process for Approval of Practice-Related Material other than Standards of Practice, this educational note has been prepared by the Committee on Workers' Compensation, and has received final approval for distribution by the Practice Council on June 11, 2009.

As outlined in subsection 1220 of the Standards of Practice, "*The actuary should be familiar with relevant Educational Notes and other designated educational material.*" That subsection explains further that a "practice which the Educational Notes describe for a situation is not necessarily the only accepted practice for that situation and is not necessarily accepted actuarial practice for a different situation." As well, "Educational Notes are intended to illustrate the application (but not necessarily the only application) of the Standards, so there should be no conflict between them."

If you have any questions or comments regarding this educational note, please contact Richard Larouche at his CIA Online Directory address, [rlarouche@eckler.ca](mailto:rlarouche@eckler.ca).

TF, RL

## Introduction

The current Standards of Practice do not require that the actuary for Public Personal Injury Compensation Plans (PPICPs) include a provision for future administration expenses in calculating their liabilities. Paragraph 5400.03 of the Standards of Practice recommends only a disclosure requirement, not an inclusion requirement. It states, “*If the benefit liabilities make no provision for administration expenses or for future claims arising from latent occupational disease, then the report should so disclose.*”

Despite the absence of such requirement in the Standards of Practice, a review of current practice shows that the liabilities for all 13 PPICPs in Canada now include a provision for future administration expenses as reported in their financial statements.

However, the Committee on Workers’ Compensation (CWC) is concerned about the apparent diversity of practice that has emerged across the 13 plans, both in the methodologies used to determine the provision for future administration expenses, and in delineating which items would be included therein.

In considering how best to address this diversity and narrow the range of practice, the CWC considered the options of adding a requirement to the Standards of Practice that a provision for future administration expenses be included in the liabilities, issuing an educational note that provides guidance on the determination of provisions for future administration expenses and/or providing guidance to actuaries in interpreting section 3461 of the CICA Handbook. After some debate, the CWC decided to issue this educational note.

The purpose of the educational note is to provide guidance and support to actuaries of PPICPs in determining and disclosing provisions for future administration expenses intended for inclusion in PPICP financial statements.

## Context

In the early 1990s, the Association of Workers’ Compensation Boards of Canada (AWCBC) engaged an accounting firm and an actuarial consulting firm to examine consistency across the annual financial statements of Workers’ Compensation Boards.

The report recommended that financial statements should include a provision for future administration expenses. The AWCBC adopted the report, and with its auditors’ encouragement, all PPICPs now include a provision for future administration expenses in their financial statements.

Under Generally Accepted Accounting Principles (GAAP), there are no requirements for a certification regarding provision for future administration expenses. This lack of requirements notwithstanding, in 2008, provisions for future administration expenses were determined and certified by actuaries for all PPICPs in Canada.

Furthermore,

under GAAP, there is no specific guidance regarding the provision for administration expenses in respect of which expenses should be accrued or how the expenses should be attributed between prior year and current year claims,

under the Practice-Specific Standards for Public Personal Injury Compensation Plans, there is no specific guidance regarding the requirement of establishing a provision for future administration expenses, other than the above noted disclosure requirement, and

in the absence of any guidance under GAAP, the provision for future administration expenses is generally determined on the assumption that the PPICP is a going concern.

Such practices have evolved since the early 1990s and may be unique to Canadian Compensation Boards.

### **Expenses Included in the Provision**

For the provision for future administration expenses, the actuary would consider expenses that occur after the valuation date related to the relevant benefit liabilities, including portion of the overhead expense that is attributed to claim administration. It is reasonable to expect that the majority of expenses will relate to the direct ongoing management of claims. There may be other expenses that the actuary would have to consider attributing to future administration expenses as well.

The first step in developing a provision for future administration expenses would be to develop a broad list of activities currently undertaken and/or funded by the PPICP. While the list may differ by PPICP, it might include activities such as,

- safety and accident prevention services,
- enforcement of health and safety regulations,
- adjudication of new claims,
- adjudication of claim recurrences,
- management of ongoing claims, including
  - payment of lost time benefits,
  - periodic review of lost time benefits as required by legislation and policy,
  - medical rehabilitation services,
  - vocational rehabilitation services,
  - permanent impairment awards, and
  - return-to-work programs,
- development of premium rates for assessed employers,
- collection of assessments from assessed employers and recovery of incurred claim costs from self-insured employers,
- management of experience rating programs,
- management of the PPICP's investment portfolio (this refers to the functions internal to the PPICP and not charged to the investment income – it does not refer to direct expenses incurred by external fund managers and charged to the investment income or to any internal functions charged to the investment income),
- ongoing assessment of the benefit liabilities,

accounting, auditing and financial reporting,  
Information Technology services in support of PPICP activities, including  
application development,  
maintenance of existing applications,  
database support, and  
hardware and infrastructure support,  
appeals process,  
research function,  
human resources function,  
legal services, and  
executive and Board of Director functions.

The next step is to determine whether these activities relate to supporting new business or to supporting the management of ongoing claims. Some of these functions clearly relate to new business and would, therefore, not be included in the calculation of the provision for future administration expenses. Other functions may be directly related to the management of ongoing claims, while still other functions might support both new business and the management of ongoing claims. A method would also be established to allocate corporate and overhead expenses between new business and management of ongoing claims; the latter would be included in the provision for future administration expenses.

### **Calculation of the Provision**

In calculating the provision for future administration expenses, the actuary would take into account the expected lifecycle and the pattern of the associated expenses of the claims incurred prior to the valuation date.

While it is expected that the future administration expenses and anticipated benefit payments would both decline over time, the two might not decline at the same pace. The provision for future administration expenses would be based on the projected benefit payments, but would also reflect the significant differences in the expected incidence of administration expenses over the lifecycle of the claim resulting from factors such as initial adjudication of new claims, subsequent adjudication of claim recurrences and appeal of decisions. It would be acceptable practice to develop an approximate formula for the provision for future administration expenses expressed as a percentage of the benefit liabilities, either as a level percentage of benefit payments or as a percentage that varies by the different maturities. An assessment of expenses required currently to manage claims at different maturities would usually be used to establish the approximate formula.

The resulting formula would be reviewed and tested on a regular basis. An assessment of expenses currently required to manage claims at different maturities would usually be compared to the expenses determined by the approximate formula. It is expected that any such simplified formula would be reviewed no less frequently than once every three years.

**Other Considerations**

There is currently (Summer 2009) no precedent of a closure of a PPICP. Consequently, there is no precedent for the impact on continuing administration expenses. As a result, it is suggested that the actuary calculate the provision for future administration expenses assuming that the PPICP is a going concern.

The actuary would not usually include a margin for adverse deviations for future administration expenses, due to the plan's compulsory coverage and monopoly powers.