

The Alberta Lawyers Insurance Association

Non-consolidated Financial Statements
December 31, 2013



April 23, 2014

Independent Auditor's Report

To the Directors of the Alberta Lawyers Insurance Association

We have audited the accompanying non-consolidated financial statements of The Alberta Lawyers Insurance Association, which comprise the non-consolidated balance sheet as at December 31, 2013 and the non-consolidated statement of revenue, expenses and unrestricted net assets and statement of cash flows for the year ended December 31, 2013, and the related notes, which comprises a summary of significant accounting policies and other explanatory information.

Management's responsibility for the non-consolidated financial statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with Canadian accounting standards for not-for-profit organizations, and for such internal control as management determines is necessary to enable the preparation of non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these non-consolidated 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 non-consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the non-consolidated 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 non-consolidated financial statements.

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

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



Opinion

In our opinion, the non-consolidated financial statements present fairly, in all material respects, the financial position of The Alberta Lawyers Insurance Association as at December 31, 2013 and the results of its operations and its cash flows for the year then ended in accordance with Canadian accounting standards for not-for-profit organizations.

PricewaterhouseCoopers LLP

Chartered Accountants

The Alberta Lawyers Insurance Association

Non-consolidated Balance Sheet

As at December 31, 2013

	December 31, 2013 \$	December 31, 2012 \$
Assets		
Current assets		
Cash and cash equivalents	12,135,918	16,672,469
Accounts receivable	4,278,153	978,135
Accrued interest receivable	388,534	313,109
Due from 1452597 Alberta Ltd. (note 7)	554,537	549,218
Due from Law Society of Alberta (note 7)	86,133	17,429
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	17,443,275	18,530,360
Investments (note 3)	100,413,317	91,632,776
Capital assets (note 4)	13,864	27,745
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	117,870,456	110,190,881
	<hr/>	<hr/>
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	179,152	123,984
Levy Deficiency	1,401,262	1,657,694
Deferred revenue	11,219,855	10,058,245
	<hr/>	<hr/>
	12,800,269	11,839,923
Reserve for claims and related costs (note 6)	66,072,000	64,338,000
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Net assets		
Unrestricted	38,998,167	34,012,938
Share capital (note 5)	20	20
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	38,998,187	34,012,958
	<hr/>	<hr/>
	117,870,456	110,190,881
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Approved by the Board of Directors

_____ Director

_____ Director

The accompanying notes are an integral part of the financial statements.

The Alberta Lawyers Insurance Association

Non-consolidated Statement of Revenue, Expenses and Unrestricted Net Assets
For the year ended December 31, 2013

	December 2013 \$	For the 6 months ended December 31, 2012 \$	For the year ended June 30, 2012 \$ (unaudited – note 2)
Revenue			
Annual levy	21,473,815	8,500,627	18,888,275
Investment income	7,860,686	5,355,230	5,487,845
	<u>29,334,501</u>	<u>13,855,857</u>	<u>24,376,120</u>
Expenses			
Provision for claims and related costs (note 6)	18,698,262	8,117,718	19,982,475
Premium paid to the Canadian Lawyers Insurance Association	4,266,828	2,422,728	4,417,920
Provision for input tax credits	2,006,285	-	-
Salaries and employee benefits	1,887,931	886,550	1,813,032
Management fee (note 7)	1,692,000	678,000	1,337,360
Investment counsel fee	262,560	131,215	244,750
Administration	144,169	56,614	131,812
Professional fees	95,808	74,394	112,829
Loss prevention	25,575	2,400	19,575
Amortization	14,773	7,297	28,855
Bad debt	1,733	-	(1,482)
	<u>29,095,924</u>	<u>12,376,916</u>	<u>28,087,126</u>
Excess of revenue over expenses for the year before the following	238,577	1,478,941	(3,711,006)
Unrealized gain on the fair market value of investments	4,746,652	61,180	319,019
Excess of revenue over expenses for the year	4,985,229	1,540,121	(3,391,987)
Unrestricted net assets – beginning of year	<u>34,012,938</u>	<u>32,472,817</u>	<u>35,864,824</u>
Unrestricted net assets – end of year	<u>38,998,167</u>	<u>34,012,938</u>	<u>32,472,837</u>

The accompanying notes are an integral part of the financial statements.

The Alberta Lawyers Insurance Association

Non-consolidated Statement of Cash Flows

For the year ended December 31, 2013

	December 2013 \$	For the 6 months ended December 31, 2012 \$	For the year ended June 30, 2012 \$ (unaudited – note 2)
Cash provided by (used in)			
Operating activities			
Excess (deficiency) of revenue over expenses for the period	4,985,229	1,540,121	(3,391,987)
Items not affecting cash			
Amortization	14,773	7,297	28,855
Gain on sale of investments	(5,174,911)	(3,641,526)	(2,484,840)
Unrealized gain on fair market value of investments	(4,746,652)	(61,180)	(319,019)
Provision for claims and related costs (note 6)	18,698,262	8,117,718	19,982,475
	13,776,701	5,962,430	13,815,484
Changes in non-cash working capital items	(2,489,120)	(3,297,371)	373,850
Claims and related costs paid – net of recoveries (note 6)	(16,964,262)	(6,399,718)	(12,716,475)
	(5,676,681)	(3,734,659)	1,472,859
Investing activities			
Proceeds on disposal of investments	29,580,453	28,454,367	23,150,031
Purchase of investments	(28,439,432)	(30,595,720)	(21,242,445)
Purchase of capital assets	(891)	-	(23,772)
	1,140,130	(2,141,353)	1,883,814
(Decrease) increase in cash and cash equivalents	(4,536,551)	(5,876,012)	3,356,673
Cash and cash equivalents – beginning of year	16,672,469	22,548,481	19,191,808
Cash and cash equivalents – end of year	12,135,918	16,672,469	22,548,481
Cash and cash equivalents are comprised of			
Cash	1,289,176	1,489,942	8,557,168
Cash equivalents	10,846,742	15,182,527	13,991,313
	12,135,918	16,672,469	22,548,481
Interest received	1,626,127	969,307	2,047,465

The accompanying notes are an integral part of the financial statements.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

1 General

The Alberta Lawyers Insurance Association (the “Association”) was incorporated on June 6, 1988 under Part 9 of the Companies Act of Alberta, chapter C-21, RSA 2000. On January 30, 2006, the Association was converted from a company limited by guarantee to a company limited by shares (see note 5). The Association administers a program under which active members of the Law Society of Alberta (the “Law Society”) in private practice (insured lawyers) have mandatory coverage for errors and omissions of \$1,000,000 per occurrence, with an annual aggregate limit of \$2,000,000. The Association has contracted with the Canadian Lawyers Insurance Association (“CLIA”) for group coverage subject to a group deductible of \$300,000 (effective July 1, 2013 the deductible is \$500,000) for each claim. The Association is subject to premiums and other assessments that may arise from the agreement with CLIA. The Association meets the qualifications of a non-profit organization as defined by the Income Tax Act and as such is exempt from taxes. The financial statements of the Association are prepared on a non-consolidated basis (refer to Note 7 “Related Party Transactions”).

On June 9th, 2012, the Board of Directors of the Association approved a change in the fiscal year-end of the Association to December 31st to be effective as at December 31, 2012.

2 Summary of significant accounting policies

Basis of accounting

These financial statements are prepared in accordance with Canadian Accounting Standards for not for profit organizations (ASNPO) as issued by the Canadian Accounting Standards Board.

Use of estimates

The preparation of the financial statements in conformity with Canadian accounting standard not-for-profit organizations (ASNPO) requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

Revenue recognition

The Association follows the deferral method for revenue recognition. The levy is determined prior to July 1st annually, the commencement of the policy year, and amounts are due from insured lawyers prior to that date. Levy revenue is recorded evenly throughout the fiscal year. Amounts received or receivable from insured lawyers that pertain to the period subsequent to fiscal year end are deferred and recorded as revenue in the next fiscal year.

Investment income

Investment income comprises of interest, dividends, fund distributions, and gains and losses realized on the disposal of investments. Interest and dividends earned on investments are included as revenue on an accrual basis. The change in fair value of investments is recorded in the statement of revenue, expenses and net assets as an unrealized gain (loss).

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

Reserve and Provision for claims and related costs

The provision for claims and related costs is based upon the change from year to year in the reserve for claims and related costs. The reserve amount is the actuarially determined discounted cost of possible claims and related costs as at the end of the fiscal year.

The Association has engaged a third party actuary to provide an annual valuation of the reserve for claims and related costs in accordance with the standards of practice adopted by the Canadian Institute of Actuaries. For the purpose of the actuarial valuation, the actuary uses information contained in the Association's financial records.

Recoveries

Recoveries for claims and related costs from insurers and other third parties are recorded when they can be reasonably estimated and collectability is reasonably assured. Otherwise, the recovery is recorded when received.

Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments comprised of treasury bills that are readily convertible to known amounts of cash and have an insignificant risk of change in value.

Capital assets

Capital assets are recorded at cost net of accumulated amortization. Amortization is calculated on a straight-line basis at the following annual rates:

Furniture and equipment	20%
Computers	33 1/3%

Donated services

A portion of the Association's work is dependent on the services of volunteers, in particular the significant contribution of the Benchers of the Law Society, the Insurance Committee, and the Claims Committee. These services are not normally purchased by the Association and, due to the difficulty in determining their fair value, donated services are not recognized in these financial statements.

Financial instruments

The Association initially measures financial assets and financial liabilities at fair value. It subsequently measures its investments at fair value. The financial assets subsequently measured at amortized cost include cash and cash equivalents, accounts receivable and accrued interest receivable. The financial liabilities subsequently recorded at amortized cost include accounts payable and accrued liabilities.

The Association's investments consist of equity securities, corporate bonds, municipal government bonds, provincial government bonds and federal government bonds. The investment in equity securities which are traded on an active market are recorded at fair value. The Association has elected to record the investments in corporate bonds, municipal government bonds, provincial government bonds and federal government bonds at fair value. Changes in fair value of the investments are recorded on the statement of revenue, expenses and unrestricted net assets. The investments which are not traded on the active market are recorded at cost.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

Financial assets are tested for impairment at the end of each reporting period when there are indications that the assets may be impaired.

Comparative figures

Certain prior year figures have been reclassified to conform to the presentation in the current year's financial statements. Certain comparative figures are marked as unaudited as no audit procedures were performed over the comparative figures under Canadian accounting standards for not-for-profit organizations. An unmodified audit report was issued for the financial statements for the year ended June 30, 2012 dated November 29, 2012, under the Canadian Generally Accepted Accounting Principles in force at that time, Canadian Institute of Chartered Accountants' Handbook Part V, Pre-changeover accounting standards.

3 Investments

The Association's investments are governed by a Statement of Investment Policies and Goals as approved by the Benchers of the Law Society of Alberta and managed under contract with an investment manager. The Association's investments are carried at fair market value, subject to normal market fluctuations, and the statement of revenue, expenses, and net assets reports both realized and unrealized gains and losses on investments. The Association's investments consist of bonds and equity investments.

Investments are as follows:

	December 31, 2013 \$	December 31, 2012 \$
Bonds denominated in Canadian dollars:		
Corporate	21,101,906	19,706,962
Municipal government	2,121,440	-
Provincial government	16,023,165	14,609,022
Federal government	17,943,547	16,515,487
	<u>57,190,058</u>	<u>50,831,471</u>
Equities denominated in Canadian dollars:	43,223,259	40,801,305
	<u>100,413,317</u>	<u>91,632,776</u>

4 Capital assets

	December 31, 2013			December 31, 2012
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Furniture and equipment	43,630	32,789	10,841	18,675
Computers	18,140	15,117	3,023	9,070
	<u>61,770</u>	<u>47,906</u>	<u>13,864</u>	<u>27,745</u>

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

5 Share capital

On January 30, 2006, the Association was converted from a company limited by guarantee to a company limited by shares. As a result of this conversion, share capital of \$20 was issued representing four common shares; three shares issued to the Law Society and one common share issued to the person from time to time holding the office of Executive Director of the Law Society, as bare trustee for the Law Society.

6 Reserve for claims and related costs

The change in the reserve for claims and related costs is summarized as follows:

	For the year ended December 31, 2013 \$	For the 6 months ended December 31, 2012 \$
Reserve for claims and related costs – beginning of period	64,338,000	62,620,000
Claims paid and accrued	(21,940,952)	(4,093,687)
Related costs paid and accrued	(5,764,362)	(2,833,588)
Recoveries	10,741,052	527,557
	<u>(16,964,262)</u>	<u>(6,399,718)</u>
Increase due to claims experience	18,698,262	8,117,718
Reserve for claims and related costs – end of period	<u>66,072,000</u>	<u>64,338,000</u>
Actuarial liability	57,093,000	58,549,000
Provision for incurred but unreported claims	8,979,000	5,789,000
Reserve for claims and related costs	<u>66,072,000</u>	<u>64,338,000</u>

Included in Provision for claims and related costs on the Non-consolidated statement of revenue, expenses and unrestricted net assets are the increase due to claims experience of \$18,698,262 (December 31, 2012 - \$8,117,718).

A portion of the reserve for claims and related costs is expected to be paid within the next fiscal year. This amount cannot be reasonably determined and therefore has not been included in current liabilities.

The discount rate applied by the actuary at December 31, 2013 is 3.45% (December 31, 2012 – 3.15%). The undiscounted reserve balance at December 31, 2013 is \$63,844,000 (December 31, 2012 – \$62,345,000).

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

7 Related party transactions

As described in note 6, the Association is a wholly owned subsidiary of the Law Society. During the period, the Association paid the Law Society an amount of \$1,692,000 (6 month period ended December 2012 – \$678,000) for management fees. The balance due from the Law Society at December 31 of \$86,133 (December 2012 – \$17,429 due to the Law Society) is non-interest bearing and due on demand.

The elected Benchers of the Law Society include members drawn from law firms across the province. These law firms may at times be engaged by the Association in the normal course of business. During the year ended December 31, 2013, expenses of \$5,943,820 (6 month period ended December 31, 2012 - \$1,617,919) were incurred with these law firms. The Benchers are not involved in retaining these firms.

1452597 Alberta Ltd. (“1452597”) is a wholly owned subsidiary of the Association and was incorporated on February 12, 2009 under the Business Corporations Act. Share capital of \$1 consists of 100 common shares.

The sole purpose of 1452597 is to hold real property obtained under the terms of a claim settlement regarding the Association’s insurance coverage for members of the Law Society. The claim will be concluded by selling the property and transferring the net proceeds to the Association at which time 1452597 will be wound up.

The Association does not consolidate the results of 1452597 in its financial statements as permitted by CPA 4450 “Reporting Controlled and Related Entities by Not-for-Profit Organizations” and CPA 4460 “Disclosure of Related Party Transactions”. A summary of 1452597’s financial information at December 31 is as follows:

	December 31, 2013 \$	For the 6 months ended December 2012 \$
Assets	530,354	530,265
Liabilities	554,537	549,218
Net assets	<u>(24,183)</u>	<u>(18,953)</u>
Expenses	<u>5,307</u>	<u>2,144</u>
Deficiency of revenues over expenditures	<u>(5,307)</u>	<u>(2,144)</u>
Cash flows from operating activities	-	-
Increase in cash and cash equivalents	<u>-</u>	<u>-</u>

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

8 Financial instruments

Interest rate risk

Treasury bills have a maturity date within a year from the balance sheet date and bear an interest rate of 0.90% (December 2012 – 0.92%).

The Association is exposed to interest rate fluctuations on its floating rate long-term debt. Included in investments are fixed income bonds in the amount of \$57,190,058 (December 2012 – \$50,831,471). The maturity dates and interest rate ranges are as follows:

Maturity dates (from balance sheet date)	Interest rate range	Market value \$	Interest rate range	Market value \$
	December 2013		December 2012	
Within five years	1.33 – 4.80%	19,843,706	1.34 – 4.854%	20,618,629
Greater than five years but less than ten years	2.65 – 5.68%	25,994,960	2.65 – 5.68%	16,946,085
Greater than ten years	2.50 – 4.70%	11,351,392	1.50 – 4.70%	13,266,757
		<u>57,190,058</u>		<u>50,831,471</u>

The Association manages the interest rate risk on fixed income bonds by engaging an investment manager who operates subject to investment parameters designed to mitigate this risk.

Price risk

The investments of the Association are subject to price risk because changing interest rates impact the market value of the fixed rate investments, general economic conditions affect the market value of equity investments and currency exchange rates impact the market value of the investments denominated in currencies other than the Canadian dollar. The risk is mitigated by engaging an investment manager for the long term portfolio investments and by investing other funds in short term fixed rate products with high credit ratings.

Credit risk

The Association, in the normal course of business, is exposed to credit risk from its customers. The Association's financial assets that are exposed to credit risk consist primarily of accounts receivable. The Association manages credit risk by maintaining bank accounts with reputable financial institutions, only investing in securities that are liquid, highly rated and traded in active markets and by insuring accounts receivable are small and from reputable, credit-worthy members/organizations.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the year ended December 31, 2013

Liquidity risk

The Association engages an investment manager to administer the investments it plans to hold for a long period of time. These investments are subject to liquidity risk if the Association is required to sell at a time that the market for these investments is unfavourable.

9 Equity in Canadian Lawyers Insurance Association

The Association is a subscriber to the Canadian Lawyers Insurance Association (CLIA), a reciprocal insurance exchange through which the law societies of ten provinces and territories (or their associated liability insurance entities) enter into agreements of mutual indemnification. Separate reserves are maintained by CLIA with respect to risks assumed and the Association has an interest in surpluses in these reserves. CLIA prepares annual Subscriber Accounts, as at the end of CLIA's fiscal year (December 31), which are approved by the CLIA Advisory Board. These accounts include a reserve for claims liabilities on a discounted basis. On that basis, the Subscriber Accounts of CLIA as at December 31, 2012 show the Association's equity to be approximately \$7.8 million (December 31, 2011 – \$8.0 million). The Association's equity is not reflected in these financial statements.

10 Subsequent events

Subsequent to the year end, the Association has withdrawn from CLIA effective June 30, 2014. In its place, and subject to regulatory approval, the Alberta Lawyers Insurance Exchange (ALIEX) has been created effective July 1, 2014. ALIEX is a reciprocal insurance exchange through which the Law Society, the Association and insured lawyers enter into agreements of mutual indemnification.