The Alberta Lawyers Insurance Association

Non-consolidated Financial Statements
December 31, 2014

February 26 2015

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, 2014 and the non-consolidated statement of revenue, expenses and unrestricted net assets and statement of cash flows for the year then ended, and the related notes, which comprise 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 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.

Opinion

In our opinion, the non-consolidated financial statements present fairly, in all material respects, the financial position of Alberta Lawyers Insurance Association as at December 31, 2014 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

PricewaterhouseCoopers LLP
111 5th Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3
T: +1 403 509 7500, F: +1 403 781 1825

The Alberta Lawyers Insurance Association

Non-consolidated Balance Sheet

As at December 31, 2014

	December 31, 2014 $	December 31, 2013 $
Assets		
Current assets		
Cash and cash equivalents	17,523,032	12,135,918
Accounts receivable	5,504,821	4,278,153
Prepaid expenses	2,464,925	-
Accrued interest receivable	264,629	388,534
Due from 1452597 Alberta Ltd. (note 8)	400,000	554,537
Due from Law Society of Alberta (note 8)	10,336	86,133
	26,167,743	17,443,275
Investments (note 3)	93,790,989	100,413,317
Capital assets (note 4)	3,852	13,864
	119,962,584	117,870,456
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	158,032	179,152
Levy Deficiency (note 11)	1,697,770	1,401,262
Deferred revenue	12,002,042	11,219,855
	13,857,844	12,800,269
Long term liabilities		
Pension plan payable (note 7)	311,241	-
Reserve for claims and related costs (note 6)	70,996,000	66,072,000
	71,307,241	66,072,000
Net assets		
Unrestricted	34,797,479	38,998,167
Share capital (note 5)	20	20
	34,797,499	38,998,187
	119,962,584	117,870,456

Approved by the Board of Directors

Original signed by A. Kirker , QC Director

Orginal signed by D. Thompson, QC 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, 2014

	December 2014 $	December 2013 $
Revenue		
Annual levy	22,750,714	21,473,815
Investment income	9,688,604	7,860,686
Voluntary excess insurance administration fee	140,705	-
Management fee (note 8)	100,000	-
	32,680,023	29,334,501
Expenses		
Provision for claims and related costs (note 6)	21,551,913	18,698,262
Premium paid to the Canadian Lawyers Insurance Association	4,415,714	4,266,828
Premium paid to the Alberta Lawyers Insurance Exchange (note 8)	1,984,925	-
Salaries and employee benefits	2,407,203	1,887,931
Management fee (note 8)	1,860,000	1,692,000
Provision for input tax credits	636,903	2,006,285
Fair value write-down of due from 1452597 Ab Ltd. (note 8, 13)	163,079	-
Reinsurance	480,000	-
Investment counsel fee	277,636	262,560
Administration	220,522	144,169
Professional fees	113,358	95,808
Loss prevention	16,650	25,575
Amortization	10,011	14,773
Bad debt	7,821	1,733
	34,145,735	29,095,924
Deficiency of revenue over expenses for the year before the following	(1,465,712)	238,577
Unrealized gain on the fair market value of investments	2,265,024	4,746,652
Excess of revenue over expenses for the year	799,312	4,985,229
Unrestricted net assets – beginning of year	38,998,187	34,012,938
Less: Contribution to the Alberta Lawyers Insurance Exchange (note 8)	5,000,000	-
Unrestricted net assets – end of year	34,797,499	38,998,167

The Alberta Lawyers Insurance Association

Non-consolidated Statement of Cash Flows

For the year ended December 31, 2014

	December 2014 $	December 2013 $
Cash provided by (used in)		
Operating activities		
(Deficiency) excess of revenue over expenses for the year	(4,200,688)	4,985,229
Items not affecting cash		
Amortization	10,011	14,773
Gain on sale of investments	(6,630,430)	(5,174,911)
Unrealized gain on fair market value of investments	(2,265,024)	(4,746,652)
Provision for claims and related costs (note 6)	21,551,913	18,698,262
	8,465,782	13,776,701
Increase (decrease) in pension plan payable	311,241	-
Changes in non-cash working capital items	(2,279,779)	(2,489,120)
Claims and related costs paid – net of recoveries (note 6)	(16,627,913)	(16,964,262)
	(10,130,669)	(5,676,681)
Investing activities		
Proceeds on disposal of investments	46,367,575	29,580,453
Purchase of investments	(30,849,792)	(28,439,432)
Purchase of capital assets	-	(891)
	15,517,783	1,140,130
Increase (decrease) in cash and cash equivalents	5,387,114	(4,536,551)
Cash and cash equivalents – beginning of year	12,135,918	16,672,469
Cash and cash equivalents – end of year	17,523,032	12,135,918
Cash and cash equivalents are comprised of		
Cash	1,011,675	1,289,176
Cash equivalents	16,511,357	10,846,742
	17,523,032	12,135,918
Interest received	1,983,111	1,626,127

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 each active member of the Law Society of Alberta (the "Law Society") in private practice (insured lawyers) has mandatory coverage for errors and omissions of $1,000,000 per occurrence, with an annual aggregate limit of $2,000,000. 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 8 "Related Party Transactions").

Prior to July 1, 2014 the Association contracted with the Canadian Lawyers Insurance Association ("CLIA") for group coverage subject to a group deductible of $500,000 for each claim. The Association was subject to premiums and other assessments that arose from the agreement with CLIA. The Association withdrew from CLIA effective June 30, 2014. In its place, the Alberta Lawyers Insurance Exchange (the "Exchange") was created effective July 1, 2014. The Exchange is a reciprocal insurance exchange through which the Law Society, the Association and insured lawyers entered into agreements of mutual indemnification. The Exchange provides the Association with group coverage subject to a deductible of $500,000 for each claim. The accounting policies applied within the Exchange's financial statements are based on International Financial Reporting Standards (IFRS) effective for the period ended December 31, 2014, as approved by the Advisory Board on February 26, 2015.

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 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 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).

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 Advisory Board and committees of the Benchers and the Advisory Board. 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 active markets 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 active markets are recorded at cost.

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

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 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, 2014 $	December 31, 2013 $
Bonds denominated in Canadian dollars:		
Corporate	20,012,810	21,101,906
Municipal government	2,230,460	2,121,440
Provincial government	13,627,755	16,023,165
Federal government	17,373,418	17,943,547
	53,244,443	57,190,058
Equities denominated in Canadian dollars:	40,546,547	43,223,259
	93,790,989	**100,413,317**

4 Capital assets

	December 31, 2014			December 31, 2013
	Cost $	Accumulated amortization $	Net $	Net $
Furniture and equipment	43,630	39,778	3,852	10,841
Computers	18,140	18,140	-	3,023
	61,770	57,918	3,852	13,864

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:

	December 31, 2014 $	December 31, 2013 $
Reserve for claims and related costs – beginning of period	66,072,000	64,338,000
Claims paid and accrued	(15,054,909)	(21,940,952)
Related costs paid and accrued	(5,647,189)	(5,764,362)
Recoveries	4,074,185	10,741,052
	(16,627,913)	(16,964,262)
Increase due to claims experience	21,551,913	18,698,262
Reserve for claims and related costs – end of period	70,996,000	66,072,000
Actuarial liability	60,362,000	57,093,000
Provision for incurred but unreported claims	10,634,000	8,979,000
Reserve for claims and related costs	70,996,000	66,072,000

Included in Provision for claims and related costs on the Non-consolidated statement of revenue, expenses and unrestricted net assets is the increase due to claims experience of $21,551,913 (December 31, 2013 - $18,698,262).

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, 2014 is 2.81% (December 31, 2013 – 3.45%). The undiscounted reserve balance at December 31, 2014 is $67,178,000 (December 31, 2013 – $63,844,000).

7 Pension Plan

a) Pension plan payable

	2014 $
Pension accrued liability	205,991
Supplemental plan liability	105,250
	311,241

The Association provides a non-contributory defined benefit pension plan to eligible management employees based on earnings and years of service. Effective January 1, 2014 the Association adopted CICA 3463, and decided to use accounting valuation results. As of December 31, 2014, and on advice of the actuary, the details of the pension plan are as follows:

	2014 $
Reconciliation of fair value of plan assets	
Fair value of plan assets – beginning of period	752,876
Association contributions during period	34,717
Actual return on plan assets	112,864
Less benefits paid during period to retirees	(23,299)
Fair value of plan assets – end of period	877,158
Reconciliation of the accrued benefit obligation	
Accrued benefit obligation – beginning of period	901,723
Current service cost	50,334
Interest on accrued benefit obligation	42,559
Actuarial (loss) gain during period	111,832
Less benefits paid during period to retirees	(23,200)
Accrued benefit obligations – end of period	1,083,149
Plan deficit	(205,991)

	2014 $
Pension cost	
Current service cost	50,334
Interest cost on accrued benefit obligation	42,559
Actual return on plan assets	(112,864)
Amortization of past service cost	-
Net actuarial (gains) losses	111,832
Pension cost recognized during period	91,861
Accrued benefit asset	
Beginning balance – Accrued benefit liability	-
Adjustment for transition to CICA 3463 Jan 1, 2014	(148,847)
Plus contributions in the period	34,717
Less pension cost during period	(91,861)
Ending balance – Accrued benefit liability	(205,991)
Reconciliation of accrued benefit liability	
Funded status (plan deficit)	(205,991)
Unamortized net actuarial loss	-
Accrued benefit liability	(205,991)

Plan assets

The plan assets are invested in a variety of financial instruments from money market to primarily a mix of fixed income and equity securities.

Fixed income	31%
Foreign equities	44%
Canadian equity	17%
Cash and cash equivalents	8%
	100%

Assumptions

The actuary used the following rates in their calculations:

	2014
Discount rate – beginning of period	4.65%
Discount rate – end of period	3.85%
Expected long-term rate of return on plan assets	5.75%
Rate of compensation increase	3.50%

a) Supplemental Retirement Plan

The Association provides to eligible management employees a non-funded Supplemental Retirement Plan (SRP). The SRP is based on earnings and years of service, and has been implemented to top-up the pension payments for those that are above the Canada Revenue Agency maximum.

	2014 $
Reconciliation of the accrued benefit obligation	
Accrued benefit obligation – beginning of period	56,049
Current service cost	5,419
Interest on accrued benefit obligation	2,732
Actuarial loss during period	41,050
Less benefits paid during period for retirees	(-)
Accrued benefit obligation – end of period	105,250
Pension cost	
Current service cost	5,419
Interest cost on accrued benefit obligation	2,732
Net actuarial losses	41,050
Pension cost recognized during period	49,201
Accrued benefit liability	
Beginning balance – accrued benefit liability	-
Adjustment for transition to CICA 3463 on Jan 1, 2014	(56,049)
Plus contributions in the period	-
Less pension cost recognized during period	(49,201)
Ending balance – Accrued benefit liability	(105,250)
Reconciliation of accrued benefit liability	
Funded status (plan deficit)	(105,250)
Unamortized net actuarial loss	-
Accrued benefit liability	(105,250)

8 Related party transactions

As described in note 5 the Association is a wholly owned subsidiary of the Law Society. During the year, the Association paid the Law Society an amount of $1,860,000 (December 2013 – $1,692,000) for management fees. The balance due from the Law Society at December 31 of $10,336 (December 2013 – $86,133) is non-interest bearing and due on demand.

Prior to the July 1, 2014 commencement of the operations of the Exchange, the Association provided $5 million in contributed capital to the Exchange. This amount has been recorded as a reduction in the Association's unrestricted net assets in the current year. During the year, the Association paid the Exchange $3,969,850 for insurance premiums of which $1,984,925 was expensed during the year and the balance of $1,984,925 was recorded as prepaid expense. The Exchange paid the Association $100,000 for management fees during the year. The Association manages claims for the Exchange.

The elected Benchers of the Law Society and the Advisory Board 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, 2014, expenses of $2,146,284 (December 31, 2013 - $5,943,820) were incurred with these law firms. The Benchers and Advisory Board members 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 insured lawyers. 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, 2014 $	**December 2013 $**
Assets	530,372	530,354
Liabilities	563,079	554,537
Net assets	(32,707)	(24,183)
Expenses	8,251	5,307
Deficiency of revenues over expenditures	(8,251)	(5,307)
Cash flows from operating activities	-	-
Increase in cash and cash equivalents	-	-

9 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 0.89% (December 2013 – 0.90%).

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 $53,244,443 (December 2013 – $57,190,058). 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 2014		December 2013	
Within five years	1.824 – 5.68%	14,657,525	1.33 – 4.80%	19,843,706
Greater than five years but less than ten years	2.40 – 4.15%	33,206,620	2.65 – 5.68%	25,994,960
Greater than ten years	3.50 – 4.70%	5,380,298	2.50 – 4.70%	11,351,392
		53,244,443		57,190,058

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.

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.

10 Equity in Canadian Lawyers Insurance Association

Effective June 30, 2014, the Association withdrew as 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) entered into agreements of mutual indemnification.
Separate reserves are maintained by CLIA with respect to risks assumed by each member of the exchange. The Association will maintain an interest in surpluses in these reserves until such time that the Association and CLIA reach mutually agreeable terms of winding up claims that existed prior to July 1, 2014. 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, 2013 show the Association's equity to be approximately $3.8 million (December 31, 2012 – $7.8 million). The Association's equity is not reflected in these financial statements.

11 Levy deficiency

The levy deficiency represents the difference between the projected costs of the insurance program from January 1, 2105 to June 30, 2015 and the deferred revenue recorded at December 31, 2014. The levy deficiency does not include offsetting investment income that will accrue to the Association from January 1, 2015 to June 30, 2015.

12 Provision for input tax credits

The Canada Revenue Agency (CRA) has initially ruled the Association is not entitled to collect Goods and Services Tax (GST) and claim input tax credits on expenses paid. The Association has filed a Notice of Objection with CRA but had not received a response prior or subsequent to the end of the current fiscal year. The Association has been required to remit input tax credits claimed to the end of the current fiscal period. These input tax credits have been recorded as expense in the current fiscal year.

13 Subsequent events

Subsequent to the year end, 1452597 Alberta Ltd. sold the property obtained under the terms of a claim settlement for $400,000. The balance owing to the Association as at December 31, 2014 was $563,079, requiring a fair value write-down of the balance due from 1452597 Alberta Ltd of $163,079 which is recorded as an expense.

14 Commitments

The Association is committed to paying a retroactive-assessment to CLIA in the amount of $5,084,188. One half (or $2,542,094) of this assessment was paid on July 1, 2014. The balance of the assessment is due in four equal annual installments as follows:

	$
2015	635,523
2016	635,523
2017	635,524
2018	635,524