

The Alberta Lawyers Insurance Association

Non-consolidated Financial Statements
June 30, 2012



November 29, 2012

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 June 30, 2012 and the non-consolidated statements of revenue, expenses and net assets and non-consolidated 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 non-consolidated financial statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with Canadian generally accepted accounting principles, 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 June 30, 2012 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

The Alberta Lawyers Insurance Association

Non-consolidated Balance Sheet

As at June 30, 2012

	2012 \$	2011 \$
Assets		
Current assets		
Cash and cash equivalents (note 2)	22,548,481	19,191,808
Accounts receivable	6,141,080	5,014,580
Accrued interest	359,831	350,407
Prepaid expenses	1,124	-
Due from 1452597 Alberta Ltd. (note 7)	547,074	543,257
	<hr/>	<hr/>
	29,597,590	25,100,052
Investments (note 3)	85,788,717	84,892,443
Capital assets (note 4)	35,042	40,125
	<hr/>	<hr/>
	115,421,349	110,032,620
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	801,674	457,692
Due to The Law Society of Alberta (note 7)	28,128	25,253
Deferred revenue (note 2)	19,498,710	18,330,851
	<hr/>	<hr/>
	20,328,512	18,813,796
Reserve for claims and related costs (note 6)	62,620,000	55,354,000
	<hr/>	<hr/>
Net assets		
Unrestricted	32,472,817	35,864,804
Share capital (note 5)	20	20
	<hr/>	<hr/>
	32,472,837	35,864,824
	<hr/>	<hr/>
	115,421,349	110,032,620

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 Net Assets
For the year ended June 30, 2012

	2012 \$	2011 \$
Revenue		
Annual levy	18,888,275	17,470,612
Investment income	5,487,845	5,717,083
	<hr/> 24,376,120	<hr/> 23,187,695
Expenses		
Provision for claims and related costs (note 6)	19,982,475	16,167,748
Premium paid to the Canadian Lawyers Insurance Association	4,417,920	4,206,388
Salaries and employee benefits	1,813,032	1,772,850
Management fee (note 7)	1,337,360	1,258,588
Investment counsel fee	244,750	243,345
Administration	131,812	87,951
Professional fees	112,829	86,379
Loss prevention	19,575	26,735
Amortization	28,855	19,198
Bad debt recovery	(1,482)	-
	<hr/> 28,087,126	<hr/> 23,869,182
Deficiency of revenue over expenses for the year before the following	(3,711,006)	(681,487)
Unrealized gain on the fair market value of investments	319,019	5,207,816
(Deficiency) excess of revenue over expenses for the year	(3,391,987)	4,526,329
Unrestricted net assets – beginning of year	<hr/> 35,864,824	<hr/> 31,338,495
Unrestricted net assets – end of year	<hr/> <u>32,472,837</u>	<hr/> <u>35,864,824</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 June 30, 2012

	2012 \$	2011 \$
Cash provided by (used in)		
Operating activities		
Excess (deficiency) of revenue over expenses for the year	(3,391,987)	4,526,329
Items not affecting cash		
Amortization	28,855	19,198
Gain on sale of investments	(2,484,840)	(2,695,431)
Unrealized gain on fair market value of investments	(319,019)	(5,207,816)
Provision for claims and related costs (note 6)	19,982,475	16,167,748
	<u>13,815,484</u>	<u>12,810,028</u>
Changes in non-cash working capital items	373,850	642,221
Claims and related costs paid – net of recoveries (note 6)	(12,716,475)	(15,847,748)
	<u>1,472,859</u>	<u>(2,395,499)</u>
Investing activities		
Proceeds on disposal of investments	23,150,031	32,328,402
Purchase of investments	(21,242,445)	(24,266,270)
Purchase of capital assets	(23,772)	(13,530)
	<u>1,883,814</u>	<u>8,048,602</u>
Increase in cash and cash equivalents	3,356,673	5,653,103
Cash and cash equivalents – beginning of year	19,191,808	13,538,705
Cash and cash equivalents – end of year	<u>22,548,481</u>	<u>19,191,808</u>
Cash and cash equivalents are comprised of		
Cash	8,557,168	9,619,524
Short-term investments	13,991,313	9,572,284
	<u>22,548,481</u>	<u>19,191,808</u>
Interest received	2,047,465	2,082,243

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

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

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 6). 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 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”).

2 Summary of significant accounting policies

Revenue recognition

The levy is determined prior to the end of the fiscal year and amounts are due from insured lawyers prior to July 1st. Levy revenue is recorded evenly throughout the year. Amounts received or receivable from insured lawyers that pertain to the period subsequent to the year-end are recorded as deferred revenue.

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).

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 value is the determined discounted cost of possible claims and related costs as at the end of the fiscal year determined by actuarial valuation.

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 is making use of certain 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.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

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.

Use of estimates

Some items in the financial statements are measured using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned course of action. The most significant of these is an estimate for the reserve for claims and related costs. It is possible, based on existing knowledge, that change in future conditions would require a material change in the recognized amounts of certain items.

Financial instruments

The Association's financial instruments are cash and cash equivalents, accounts receivable, accrued interest, due to (from) The Law Society of Alberta, due from 1452597 Alberta Ltd., investments, accounts payable and accrued liabilities.

The Association has classified each financial instrument into the following categories:

Category	Financial Instrument
Loans and receivables	Accounts receivable, accrued interest, due to (from) the Law Society of Alberta, due from 1452597 Alberta Ltd.
Held-for-trading	Investments, cash and cash equivalents
Other financial liabilities	Accounts payable and accrued liabilities

Financial instruments must initially be recognized at fair value on the balance sheet. Subsequent measurement of the financial instruments is based on their classification. Cash and cash equivalents are measured at cost which approximates fair market value due to their short term nature. Loans, receivables and financial liabilities are measured at cost or amortized cost. Held-for-trading investments are measured at fair market value with unrealized gains or losses recognized in the statement of revenue, expenses, and net assets.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

3 Investments

The Association's investments are 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 at June 30 are as follows:

	2012 \$	2011 \$
Bonds denominated in Canadian dollars:		
Corporate	17,890,849	17,283,005
Municipal government	2,205,140	2,171,980
Provincial government	11,628,855	12,203,932
Federal government	15,732,264	14,950,342
	47,457,108	46,609,259
Equities denominated in Canadian dollars:		
	38,331,609	38,283,184
	85,788,717	84,892,443

4 Capital assets

	2012		2011	
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Furniture and equipment	42,739	19,790	22,949	25,865
Computers	56,310	44,217	12,093	14,260
	99,048	64,006	35,042	40,125

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.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

6 Reserve for claims and related costs

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

	2012 \$	2011 \$
Reserve for claims and related costs – beginning of year	55,354,000	55,034,000
Claims paid and accrued	(10,374,493)	(15,587,986)
Related costs paid and accrued	(5,284,602)	(5,390,676)
Recoveries	2,942,620	5,130,914
	<u>(12,716,475)</u>	<u>(15,847,748)</u>
Increase due to claims experience	19,982,475	16,167,748
Reserve for claims and related costs – end of year	<u>62,620,000</u>	<u>55,354,000</u>
Actuarial liability	58,937,000	51,171,000
Provision for incurred but unreported claims	4,223,000	4,183,000
Reserve for claims and related costs	<u>62,620,000</u>	<u>55,354,000</u>

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 June 30, 2012 is 3.25% (2011 – 4.25%). The undiscounted reserve balance at June 30, 2012 is \$60,035,000 (2011 – \$55,433,000).

7 Related party transactions

As described in note 6, the Association is a wholly owned subsidiary of the Law Society. During the year, the Association paid the Law Society an amount of \$1,337,360 (2011 – \$1,258,588) for management fees. The balance due to the Law Society at June 30 of \$28,128 (2011 – \$25,253 due from 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 June 30, 2012, expenses of \$3,325,698 (2011 - \$3,279,255) were incurred with these law 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 Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

The Association does not consolidate the results of 1452597 in its financial statements as permitted by CICA 4450 “Reporting Controlled and Related Entities by Not-for-Profit Organizations” and CICA 4460 “Disclosure of Related Party Transactions”. A summary of 1452597’s financial information at June 30 is as follows:

	2012 \$	2011 \$
Assets	530,265	530,265
Liabilities	<u>547,074</u>	<u>543,257</u>
Net assets	<u>(16,809)</u>	<u>(12,992)</u>
Expenses	<u>3,817</u>	<u>1,505</u>
Deficiency of revenues over expenditures	<u>(3,817)</u>	<u>(1,505)</u>
Cash flows from operating activities	<u>265</u>	<u>-</u>
Increase in cash and cash equivalents	<u>265</u>	<u>-</u>

8 Financial instruments

Fair value

The fair market value of all financial instruments, except for investments, approximates book value due to their short term nature. The Association records its equity investments at fair market value based upon quoted market values. Bond values are determined from multiple sources using the average bid/ask spread and at various times of day. The fair value of reserve for claims and related costs is based upon annual actuarial assessments.

Interest rate risk

Treasury bills have a maturity date within a year from the balance sheet date and bear an interest rate of 0.92% (2011 – 0.93%).

Included in investments are fixed income bonds in the amount of \$47,457,108 (2011 – \$46,609,259). 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
		\$		\$
	2012		2011	
Within five years	3.66 – 5.25%	19,662,626	4.65 – 6.15%	9,352,657
Greater than five years but less than ten years	2.65 – 5.68%	16,330,038	3.25 – 5.68%	31,392,842
Greater than ten years	2.70 – 6.45%	<u>11,464,444</u>	4.70 – 6.45%	<u>5,863,760</u>
		<u>47,457,108</u>		<u>46,609,259</u>

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

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 does not believe it is exposed to significant credit risk on any of its financial assets. The Association manages credit risk by maintaining bank accounts with reputable financial institutions, only investing in securities that are liquid, highly rated, traded in active markets and its accounts receivables are small and from reputable, credit-worthy organizations.

Currency risk

The Association is exposed to currency risk to the extent that investments are not denominated in Canadian dollars (refer to note 3). The Association has not entered into any foreign currency contracts to mitigate this risk.

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, 2011 show the Association's equity to be approximately \$8.0 million (December 31, 2010 – \$8.0 million). The Association's equity is not reflected in these financial statements.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

As at June 30, 2012

10 Capital disclosures

The Association defines its capital as the amounts included in Net Assets.

The Association's objective when managing Net Assets is to safeguard the entity's ability to continue as a going concern and to provide the appropriate level of benefits and services to its stakeholders and others in the public interest.

The Association sets the amount of unrestricted Net Assets in proportion to risk and manages the fund structure and makes adjustments to it in light of changes in economic conditions, the risk characteristics of the underlying assets, and the requirements of its stakeholders and others in the public interest.

11 Subsequent Event

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.