

**The Alberta Lawyers Insurance
Association**

Non-consolidated Financial Statements
December 31, 2012



April 11, 2013

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, 2012 and the non-consolidated statements of revenue, expenses and unrestricted net assets and cash flows for the six month period ended December 31, 2012, 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 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, 2012 and the results of its operations and its cash flows for the six month period ended December 31, 2012 in accordance with Canadian accounting standards for not-for-profit organizations.

Comparative information

Without modifying our opinion, we draw attention to note 2 to the non-consolidated financial statements, which describes that The Alberta Lawyers Insurance Association adopted Canadian accounting standards for not-for-profit organizations on July 1, 2012 with a transition date of July 1, 2011. These standards were applied retrospectively by management to the comparative information in these non-consolidated financial statements, including the non-consolidated balance sheet as at June 30, 2012 and July 1, 2011, and the non-consolidated statements of revenue, expenses and net assets and cash flows for the year ended June 30, 2012 and related disclosures. We were not engaged to report on the restated comparative information, and as such, it is unaudited.

PricewaterhouseCoopers LLP

Chartered Accountants

The Alberta Lawyers Insurance Association

Non-consolidated Balance Sheet

As at December 31, 2012

	December 31, 2012 \$	June 30, 2012 \$ (unaudited – note 2)	July 1, 2011 \$ (unaudited – note 2)
Assets			
Current assets			
Cash and cash equivalents	16,672,469	22,548,481	19,191,808
Accounts receivable	978,135	6,141,080	5,014,580
Accrued interest	313,109	359,831	350,407
Prepaid expenses	-	1,124	-
Due from 1452597 Alberta Ltd. (note 8)	549,218	547,074	543,257
Due from Law Society of Alberta (note 8)	17,429	-	-
	<u>18,530,360</u>	<u>29,597,590</u>	<u>25,100,052</u>
Investments (note 4)	91,632,776	85,788,717	84,892,443
Capital assets (note 5)	<u>27,745</u>	<u>35,042</u>	<u>40,125</u>
	<u>110,190,881</u>	<u>115,421,349</u>	<u>110,032,620</u>
Liabilities and Net Assets			
Current liabilities			
Accounts payable and accrued liabilities	123,984	801,674	457,692
Due to The Law Society of Alberta (note 8)	-	28,128	25,253
Levy Deficiency (note 7)	1,657,694	-	-
Deferred revenue	10,058,245	19,498,710	18,330,851
	<u>11,839,923</u>	<u>20,328,512</u>	<u>18,813,796</u>
Reserve for claims and related costs (note 7)	<u>64,338,000</u>	<u>62,620,000</u>	<u>55,354,000</u>
Net assets			
Unrestricted	34,012,938	32,472,817	35,864,804
Share capital (note 6)	20	20	20
	<u>34,012,958</u>	<u>32,472,837</u>	<u>35,864,824</u>
	<u>110,190,881</u>	<u>115,421,349</u>	<u>110,032,620</u>

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 six months ended December 31, 2012

	December 2012 \$	For the year ended June 30, 2012 \$ (unaudited – note 2)
Revenue		
Annual levy	10,158,321	18,888,275
Investment income	5,355,230	5,487,845
	<hr/> 15,513,551	<hr/> 24,376,120
Expenses		
Provision for claims and related costs (note 7)	9,775,412	19,982,475
Premium paid to the Canadian Lawyers Insurance Association	2,422,728	4,417,920
Salaries and employee benefits	886,550	1,813,032
Management fee (note 8)	678,000	1,337,360
Investment counsel fee	131,215	244,750
Professional fees	74,394	112,829
Administration	56,614	131,812
Amortization	7,297	28,855
Loss prevention	2,400	19,575
Bad debt recovery	-	(1,482)
	<hr/> 14,034,610	<hr/> 28,087,126
Excess (deficiency) of revenue over expenses for the period before the following	1,478,941	(3,711,006)
Unrealized gain on the fair market value of investments	61,180	319,019
	<hr/> 1,540,121	<hr/> (3,391,987)
Excess (deficiency) of revenue over expenses for the period		
Unrestricted net assets – beginning of period	32,472,817	35,864,804
Unrestricted net assets – end of period	<hr/> 34,012,938	<hr/> 32,472,817

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

The Alberta Lawyers Insurance Association

Non-consolidated Statement of Cash Flows

For the six months ended December 31, 2012

	December 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	1,540,121	(3,391,987)
Items not affecting cash		
Amortization	7,297	28,855
Gain on sale of investments	(3,641,526)	(2,484,840)
Unrealized gain on fair market value of investments	(61,180)	(319,019)
Provision for claims and related costs (note 7)	9,775,412	19,982,475
	<hr/>	<hr/>
	7,620,124	13,815,484
Changes in non-cash working capital items	(4,955,065)	373,850
Claims and related costs paid – net of recoveries (note 7)	(6,399,718)	(12,716,475)
	<hr/>	<hr/>
	(3,734,659)	1,472,859
Investing activities		
Proceeds on disposal of investments	28,454,367	23,150,031
Purchase of investments	(30,595,720)	(21,242,445)
Purchase of capital assets	-	(23,772)
	<hr/>	<hr/>
	(2,141,353)	1,883,814
(Decrease) increase in cash and cash equivalents	(5,876,012)	3,356,673
Cash and cash equivalents – beginning of period	22,548,481	19,191,808
	<hr/>	<hr/>
Cash and cash equivalents – end of period	16,672,469	22,548,481
Cash and cash equivalents are comprised of		
Cash	1,489,942	8,557,168
Short-term investments	15,182,527	13,991,313
	<hr/>	<hr/>
	16,672,469	22,548,481
Interest received	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 six months ended December 31, 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 8 “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 Transition to accounting standards for not-for-profit organizations

Effective July 1, 2012, the Association elected to adopt Canadian accounting standards for not-for-profit organizations (ASNPO) as issued by the Canadian Accounting Standards Board. The accounting policies selected under this framework have been applied consistently and retrospectively as if these policies had always been in effect.

At the date of transition, the Association has elected to designate all investments to be measured at fair value. As this is the same method used prior to the change in accounting framework, there are no adjustments to the non-consolidated balance sheet or the non-consolidated statements of revenue, expenses and unrestricted net assets and cash flows.

The Organization has not utilized any transitional exemptions on the adoption of ASNPO. There were no adjustments to the balance sheet, the statement of revenue, expenses and unrestricted net assets, or the statement of cash flows.

The 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 Summary of significant accounting policies

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.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

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.

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.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

Financial instruments

The Association records cash and cash equivalents, accounts receivable, accrued interest, due from 1452597 Alberta Ltd., due to/from Law Society of Alberta and accounts payable and accrued liabilities at amortized cost. Amortization, if any, is recorded on a straight-line basis.

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.

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

4 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 are as follows:

	December 2012 \$	June 2012 \$ (unaudited – note 2)
Bonds denominated in Canadian dollars:		
Corporate	19,706,962	17,890,849
Municipal government	-	2,205,140
Provincial government	14,609,022	11,628,855
Federal government	16,515,487	15,732,264
	<u>50,831,471</u>	<u>47,457,108</u>
Equities denominated in Canadian dollars:	<u>40,801,305</u>	<u>38,331,609</u>
	<u>91,632,776</u>	<u>85,788,717</u>

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

5 Capital assets

	December 31, 2012			June 30, 2012 (unaudited – note 2)
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Furniture and equipment	42,738	24,063	18,675	22,949
Computers	18,140	9,070	9,070	12,093
	60,878	33,133	27,745	35,042

6 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.

7 Reserve for claims and related costs

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

	For the 6 months ended December 2012 \$	For the year ended June 2012 \$ (unaudited – note 2)
Reserve for claims and related costs – beginning of period	62,620,000	55,354,000
Claims paid and accrued	(4,093,687)	(10,374,493)
Related costs paid and accrued	(2,833,588)	(5,284,602)
Recoveries	527,557	2,942,620
	(6,399,718)	(12,716,475)
Increase due to claims experience	8,117,718	19,982,475
Reserve for claims and related costs – end of period	64,338,000	62,620,000
Actuarial liability	58,549,000	58,937,000
Provision for incurred but unreported claims	5,789,000	4,223,000
Reserve for claims and related costs	64,338,000	62,620,000

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

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 \$8,117,718 (June 30, 2012 - \$19,982,475), and the levy deficiency recorded in the year of \$1,657,694 (June 30, 2012 - \$nil).

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, 2012 is 3.15% (June 30, 2012 – 3.25%). The undiscounted reserve balance at December 31, 2012 is \$62,345,000 (June 30, 2012 – \$60,035,000).

8 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 \$678,000 (year ended June 2012 – \$1,337,360) for management fees. The balance due from the Law Society at December 31 of \$17,429 (June 2012 – \$28,128 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 six month period ended December 31, 2012, expenses of \$1,617,919 (year ended June 30, 2012 - \$3,325,698) 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 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 December 31 is as follows:

	December 2012	June 2012
	\$	\$
		(unaudited – note 2)
Assets	530,265	530,265
Liabilities	549,218	547,074
Net assets	<u>(18,953)</u>	<u>(16,809)</u>
Expenses	<u>2,144</u>	<u>3,817</u>
Deficiency of revenues over expenditures	<u>(2,144)</u>	<u>(3,817)</u>
Cash flows from operating activities	-	265
Increase in cash and cash equivalents	<u>-</u>	<u>265</u>

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

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 0.92% (June 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 \$50,831,471 (June 2012 – \$47,457,108). 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
		\$		\$
			June 2012	
			(unaudited – note 2)	
Within five years	1.34 – 4.854%	20,618,629	3.66 – 5.25%	19,662,626
Greater than five years but less than ten years	2.65 – 5.68%	16,946,085	2.65 – 5.68%	16,330,038
Greater than ten years	1.50 – 4.70%	<u>13,266,757</u>	2.70 – 6.45%	<u>11,464,444</u>
		<u>50,831,471</u>		<u>47,457,108</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, traded in active markets and its 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.

The Alberta Lawyers Insurance Association

Notes to Non-consolidated Financial Statements

For the six months ended December 31, 2012

10 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.